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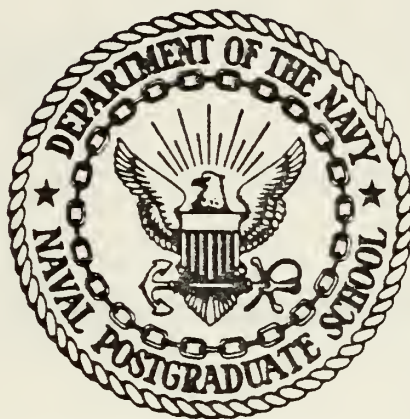
A STUDY OF INTERNAL REVIEW

John F. Dennis

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# NAVAL POSTGRADUATE SCHOOL

## Monterey, California



# THESIS

A STUDY OF INTERNAL REVIEW

by

John F. Dennis

December 1979

Thesis Advisor:

R. A. Bobulinski

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20. (continued)

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A Study of Internal Review

by

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Major, United States Marine Corps  
B.S., Louisiana Tech University, 1971

Submitted in partial fulfillment of the  
requirements for the degree of

MASTER OF SCIENCE IN MANAGEMENT

from the

NAVAL POSTGRADUATE SCHOOL  
December 1979



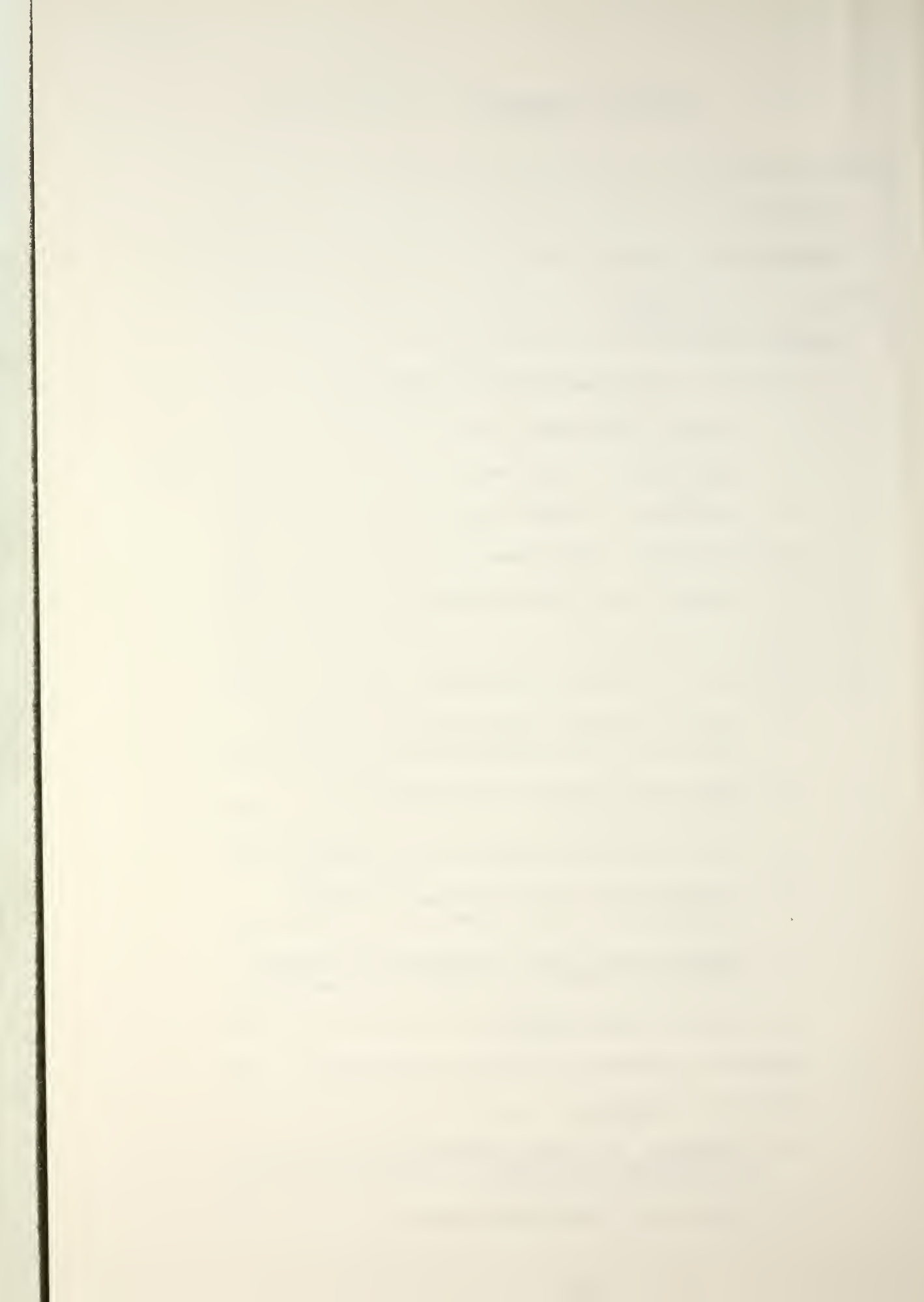
## ABSTRACT

The recent emphasis in all levels of government on accountability of resources has resulted in an increase in concern for internal control. Included in internal control systems is internal auditing. Self-review at a field activity takes the form of Internal Review. This thesis examines the conceptual basis of Internal Review by discussing auditing and more specifically internal auditing in both the Public and Private Sectors followed by a comparison with internal auditing and internal review in the Department of the Navy, including a case study of a Marine Corps Air Station Internal Review Division. Information for this thesis was collected by a library search, numerous phone calls (including calls to the Office of the Director of Internal Audit Policy for the Department of Defense, the Naval Audit Service Headquarters, and the Marine Corps Air Station in the case study), and materials provided by the Naval Audit Service and the Marine Corps Air Station. Recommendations for improvement are included for both the policy-making and operating levels of the Department of Defense and the Department of the Navy.



## TABLE OF CONTENTS

I.	INTRODUCTION-----	9
	A. PURPOSE-----	10
	B. METHODOLOGY-----	10
II.	AUDITING -- BACKGROUND-----	13
	A. PRIVATE SECTOR-----	13
	1. Generally Accepted Auditing Standards-----	15
	a. General Standards-----	15
	b. Standards of Field Work-----	15
	c. Standards of Reporting-----	16
	2. Audit Evidence Decisions-----	17
	3. The Auditor's Decision Process-----	18
	4. Types of Evidence-----	19
	5. Overview of the Audit Process-----	19
	a. Obtain a General Understanding of the Client and Its Circumstances-----	20
	b. Study and Evaluate the System of Internal Control-----	20
	c. Test the Effectiveness of the System---	23
	d. Directly Test the Financial Statement Accounts-----	23
	e. Complete the Audit, Combine the Results of all the Tests, and Draw Conclusions-	24
	f. Issue an Audit Report-----	24
	6. Effect of Computer Systems on Auditing-----	24
	7. Internal Auditing-----	26
	a. Standards for the Professional Practice of Internal Auditing-----	27
	b. Additional Considerations-----	30

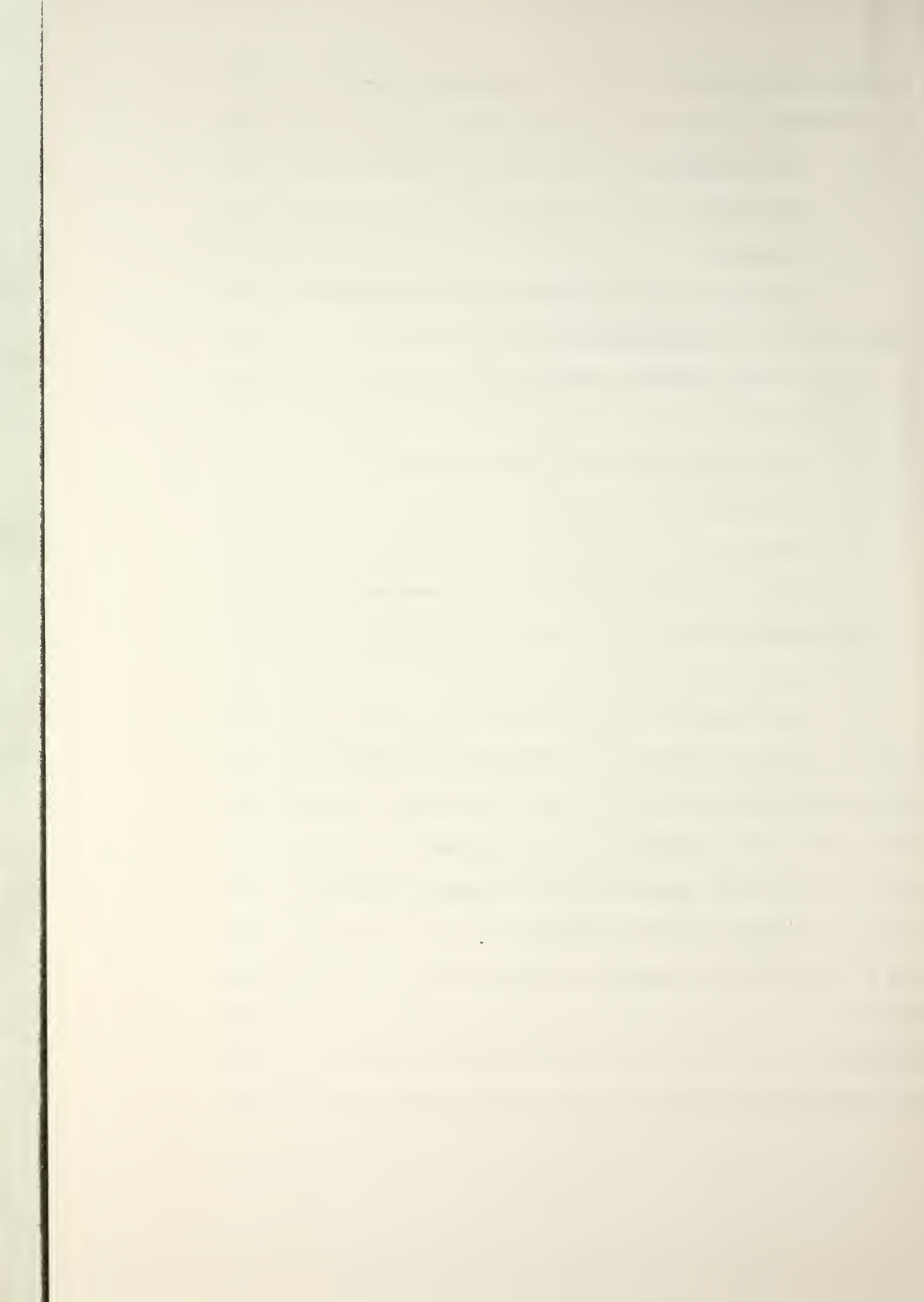


B.	PUBLIC SECTOR -- THE FEDERAL GOVERNMENT-----	33
1.	Purposes and Objectives of Audits-----	34
2.	Audit Approach-----	35
3.	Standards-----	36
a.	General Standards-----	36
b.	Examination and Evaluation Standards----	36
c.	Reporting Standards-----	37
4.	Internal Auditing in Federal Agencies-----	38
5.	Effects of Computer Systems-----	39
III.	INTERNAL AUDITING/INTERNAL REVIEW IN THE DEPARTMENT OF THE NAVY-----	41
A.	DEPARTMENT OF DEFENSE-----	41
1.	Audit Policies-----	41
2.	Internal Audit-----	42
a.	Internal Audit Responsibilities, Mission, and Scope-----	43
b.	Audit Approach-----	44
3.	Internal Review-----	44
B.	DEPARTMENT OF THE NAVY-----	46
1.	Internal Audit-----	46
2.	Internal Review-----	47
a.	Definition and Discussion-----	48
b.	Functions-----	49
c.	Staffing-----	49
d.	Audit Process-----	50
e.	Internal Review in the Marine Corps -- Differences-----	54
IV.	CASE STUDY -- MCAS-----	58





A.	THE AIR STATION-----	58
B.	INTERNAL REVIEW-----	58
1.	Organization-----	58
2.	Staffing-----	60
3.	Program-----	62
4.	Approach to the Conduct of a Review-----	63
V.	CONCLUSIONS AND RECOMMENDATIONS-----	68
A.	POLICY FOR INTERNAL REVIEW-----	68
B.	CASE STUDY-----	70
1.	Organization-----	70
2.	Staffing-----	71
3.	Program-----	71
4.	Approach to the Conduct of a Review-----	72
C.	RECOMMENDATIONS-----	73
1.	Policy-----	73
2.	Case Study-----	74
	APPENDIX A - INTERNAL REVIEW -- DEPARTMENT OF DEFENSE----	77
	APPENDIX B - TRAINING PLAN-----	81
	APPENDIX C - FY 1979 INTERNAL REVIEW PROGRAM-----	84
	APPENDIX D - REPORT OF OPERATIONS OF INTERNAL REVIEW-----	86
	APPENDIX E - INTERNAL REVIEW REPORT-----	87
	APPENDIX F - GLOSSARY OF TERMS-----	89
	FOOTNOTES-----	90
	BIBLIOGRAPHY-----	94
	INITIAL DISTRIBUTION LIST-----	97

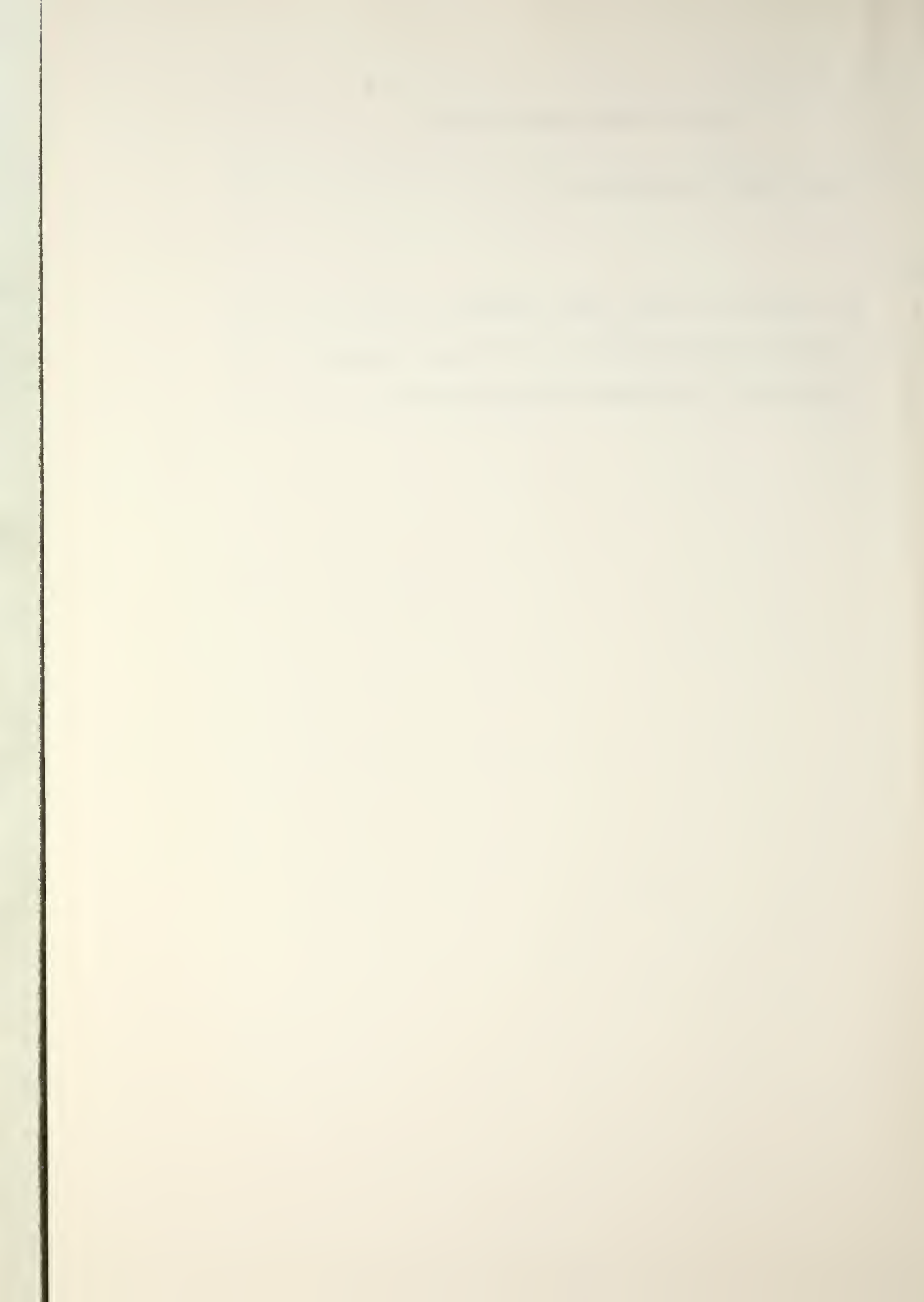


## LIST OF TABLE AND FIGURES

TABLE I	MCAS BUDGET DISTRIBUTION-----	59
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### FIGURES

1	AN OVERVIEW OF THE AUDIT PROCESS-----	21
2	SCHEMATIC DESCRIPTION OF A TYPICAL FINDING----	53
3	COMPTROLLER DEPARTMENT ORGANIZATION-----	61



## I. INTRODUCTION

"We have an obligation to manage with excellence..."<sup>1</sup>

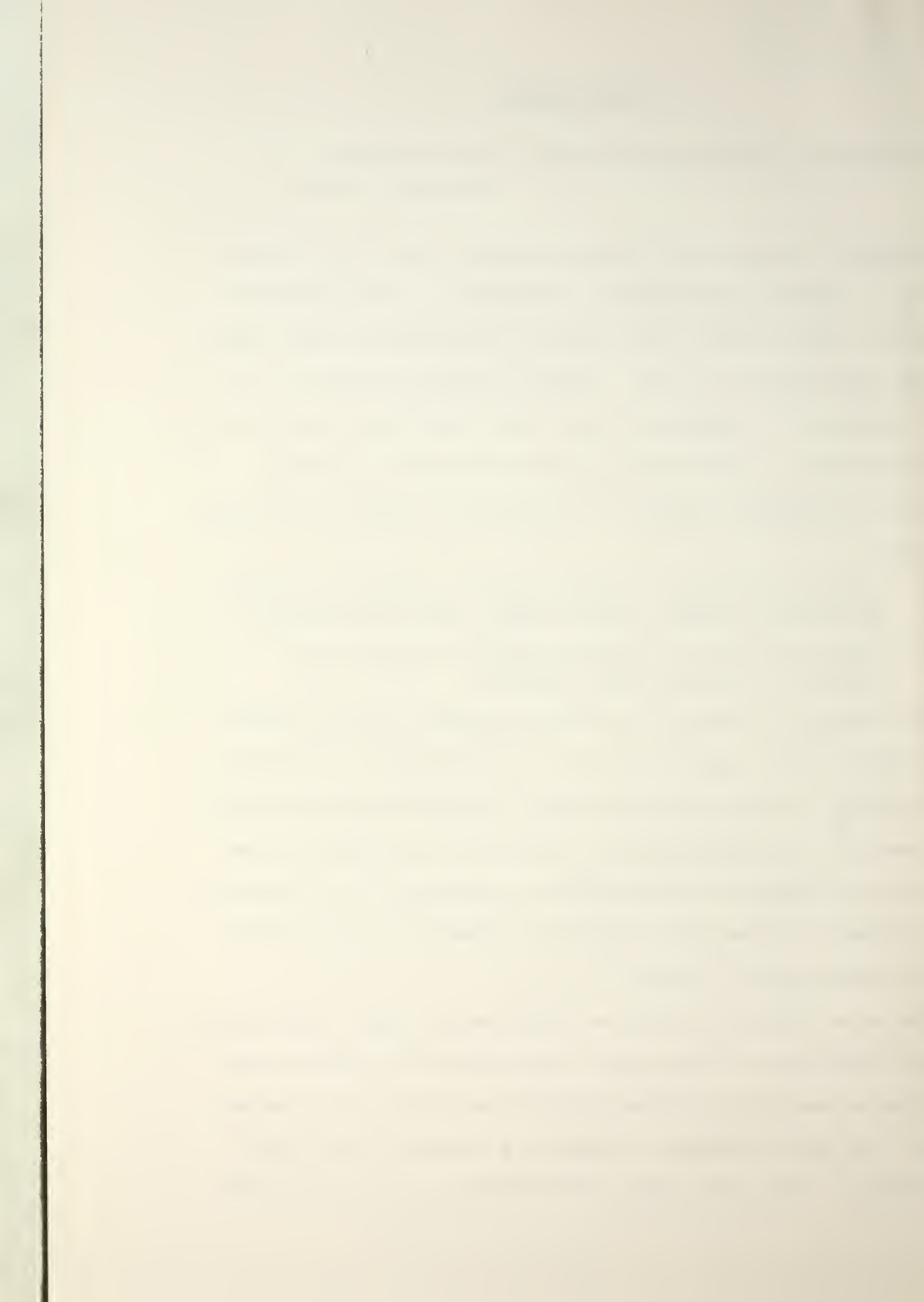
President Carter

Numerous efforts have been in progress for a long period of time to improve government's management of its financial resources, such as the Joint Financial Management Improvement Program which began in 1948. Recently there has been a renewed emphasis.<sup>2</sup> President Carter has identified nine financial priorities in the overall effort to improve existing financial management systems.<sup>3</sup> Included in these nine priorities are:

1. Internal control: upgrade control systems to reduce the risk of fraud, abuse, waste, and inefficiency.
2. Audit follow-up: resolve findings promptly and properly, and hold down backlog.

The Inspector General Act of 1978 placed various responsibilities on all agencies within the government, including the military, to identify and report fraud/abuse/waste within government.<sup>4</sup> In compliance with the Act, the Office of the Secretary of Defense has expressed an interest in all types of self review including the efforts of internal review staffs at the field activity level.<sup>5</sup>

The Naval Audit Service, as the internal audit organization for the Department of the Navy, has continually placed great emphasis on examining audited activities systems of internal control, of which internal review is a component, at field activities.<sup>6</sup> Since the Naval Audit Service is able to audit



major field activities only about once every three years, and all activities within five years, internal review becomes an even more important aspect of internal control.<sup>7</sup>

#### A. OBJECTIVE OF THE STUDY

At the present, internal review is in a period of growth and under closer scrutiny at all levels of government, but it still is not at the level of performance needed.<sup>8</sup> The purpose of this thesis is to examine the practice of internal review within the Department of the Navy, determine its requirements, and make recommendations regarding its improvement.

#### B. METHODOLOGY

The evaluation of internal review will be discussed in three basic parts: a.) conceptual foundations in the Private Sector and applications in the Public Sector, b.) internal auditing and internal review in the Department of the Navy, and c.) examination of a Marine Corps Air Station Internal Review Division for the purpose of making recommendations for improvement, with possible application at similar activities.

Chapter II discusses auditing and internal auditing in the Private and Public Sector with emphasis on the types of audits, auditing standards, and the audit process. The similarities and differences in application in both sectors are considered. Research for this chapter consisted of a library search of appropriate materials and use of the Defense Logistics Studies Information Exchange.





Internal auditing and internal review are considered in Chapter III. The limited description provided by the Department of Defense on internal review is discussed, and apparent differences between the Department of Defense and Department of the Navy directives on internal review are highlighted. The Department of the Navy audit process, which is considered by the Department of the Navy to be applicable to internal review, is examined. In addition, the present and soon-to-be-promulgated Marine Corps Orders are compared, with appropriate comments concerning the Secretary of the Navy Instruction. The material for this chapter was largely obtained from a library search, material from the Defense Logistics Studies Information Exchange, phone calls to Headquarters, Marine Corps, and the Office of the Director for Internal Audit Policy for the Department of Defense, and material from the Naval Audit Service.

Chapter IV is a discussion of the Internal Review Division of a Marine Corps Air Station organization, staffing, review program, and approach to the performance of a review. The chapter includes the narrow emphasis at the Air Station on financial resources rather than a more comprehensive approach that would include all types of resources. Material for this chapter was obtained from the Comptroller and the Internal Review Division of the Air Station through the mail, by phone, and from a visit to the Air Station by the author.

The comparison of the case study and the applicable Marine Corps Orders and Secretary of the Navy Instruction for internal review is contained in Chapter V. The chapter also includes



recommendations for improvement of Internal Review at both the policy-making and operating levels.



## II. AUDITING -- BACKGROUND

The concept of accountability for utilization of public resources entrusted to government agencies includes not only the object of their use but also the manner and effect of their use.<sup>9</sup> This idea constitutes a large part of management control, which is defined as the process by which assurance is made that resources are obtained and used effectively/efficiently in accomplishment of an organization's objectives.<sup>10</sup> The essence of management control is the corrective action taken to ensure that the performance of an organization conforms with established standards or requirements.<sup>11</sup> For such action to be taken, information must be made available to all levels of management in a timely and reliable form. To ensure such reliability, a common method is independent verification or audit.<sup>12</sup>

The common understanding of the term "audit" is reflected in the following definition:

"Auditing is an integrated process of accumulating and evaluating evidence by a competent person about quantifiable information of a specific economic entity for the purpose of determining and reporting upon the degree of correspondence between the quantifiable information and established criteria."<sup>13</sup>

This function is applicable to both the private and public sectors of any economy.

### A. PRIVATE SECTOR

The three most recognized types of audits in the private sector are:<sup>14</sup>



1. compliance audit
2. audit of financial statements
3. operational audit

The purpose of a compliance audit is to determine if the audited entity has been and is complying with rules or procedures established by higher authority. Usually internal management is the chief user of the results of such an audit.

An audit of financial statements has the purpose of determining whether the overall financial statements are correctly stated as evaluated in accordance with established criteria, usually generally accepted accounting principles. It is this type of audit that has been the most highly developed; however, the auditing process is applicable not just to financial statements but also to information systems and to the performance of economic activity. This is indicated by the increase in the number of operational audits in recent years.<sup>15</sup>

An operational audit is a review of an organization's operating procedures and methods for the purpose of evaluating efficiency and effectiveness. This type of audit is more difficult to plan and execute because of the subjective nature of evaluation criteria and the fact that the areas reviewed include not only accounting data but organizational structure, methods, operations, or any area where the auditor is qualified. All of these audit types are undertaken through a framework or Generally Accepted Accounting Principles and Generally Accepted Auditing Standards.





## 1. Generally Accepted Auditing Standards

An auditing standard is a general guideline to aid an auditor in fulfillment of his responsibilities. The standards were developed by the American Institute of Certified Public Accountants (AICPA) and consist of three types:<sup>16</sup>

- a. General standards -- personal qualities auditors should possess.
- b. Standards of field work -- concern the performance of the field work.
- c. Standards of reporting -- deal with the issuance of a proper audit report.

### a. General Standards

1.) The examination is to be performed by a person or persons having adequate technical training and proficiency as an auditor.

2.) In all matters relating to the assignment, an independence in mental attitude is to be maintained by the auditor or auditors.

3.) Due professional care is to be exercised in the performance of the examination and the preparation of the report.

### b. Standards of Field Work

1.) The work is to be adequately planned and assistants, if any, are to be properly supervised.

2.) There is to be a proper study and evaluation of the existing internal control as a basis of reliance thereon and for the determination of the resultant extent of the tests to which auditing procedures are to be restricted.



3.) Sufficient competent evidential matter is to be obtained through inspection, observation, inquiries, and confirmations to afford a reasonable basis of an opinion regarding the financial statements under examination.

c. Standards of Reporting

1.) The report shall state whether the financial statements are presented in accordance with generally accepted accounting principles.

2.) The report shall state whether such principles have been consistently observed in the current period in relation to the preceding period.

3.) Informative disclosures in the financial statements are to be regarded as reasonably adequate unless otherwise stated in the report.

4.) The report shall either contain an expression of opinion regarding the financial statements, taken as a whole, or an assertion to the effect that an opinion cannot be expressed. When an overall opinion cannot be expressed, the reasons therefore should be stated. In all cases where an auditor's name is associated with financial statements, the report should contain a clear-cut indication of the character of the auditor's examination, if any, and the degree of responsibility he is taking.

Whenever an auditing problem arises of sufficient importance to warrant an interpretation of the AICPA, Statements on Auditing Standards are issued, and together with Generally Accepted Auditing Standards, form the authoritative



literature on auditing. One important point is apparent, and this is that there are no specific audit procedures and no specific requirements for determining sample size, sample selection, or evaluating results. The commonly accepted reason for this is that rigid guidelines would limit the use of professional judgement of auditors, making an audit a mechanistic evidence gathering procedure.<sup>17</sup> More specific guidelines are found in less authoritative sources, such as textbooks, journals, and technical publications.

## 2. Audit Evidence Decisions

One of the most important judgemental problems facing every auditor is the appropriate amount of evidence required for a given audit.<sup>18</sup> The problem is one of time and money weighed against reasonable satisfaction of an accurate report. The evidence accumulation process can be broken into four interrelated decisions:<sup>19</sup>

- a. Audit procedures to use.
- b. Sample size to select for a given procedure.
- c. Particular items to select from a population.
- d. Appropriate time to perform the procedures.

In any audit area, there are some procedures that will almost always be used, which are called the minimum audit procedures. This is significant in that auditor judgement determines the appropriate procedures to be used in each case, because the AICPA has not specified a set of minimum audit procedures for each audit area.

The methodology in choosing a sample may range from the highly subjective judgement sample to the more sophisticated statistical sampling techniques, including use of





confidence levels or the more complex Bayesian statistics. Regardless of the type of method used, the only differences involve the sampling and not the procedures or tests, which are determined independent of the sample. However, judgement needs to be applied regardless of methodology.<sup>20</sup>

This aspect is related to sample size in that items may be chosen on the basis of judgement or statistical selection. The important concerns are that a representative sample is obtained and that items most likely to be in error are emphasized. Both are accomplished by taking a larger portion of certain types of items, and at the same time including some of each type of item.

### 3. The Auditor's Decision Process

An important decision in conducting every audit is determining the appropriate amount of evidence to accumulate. The decision is based on the degree of responsibility the auditor takes for the fair presentation of financial statements, and the particular circumstances in a specific audit.<sup>21</sup> Responsibility in performing an audit is generally identified as limited to performing the audit and reporting in accordance with generally accepted auditing standards. In effect, the standard of evidence accumulation used by most competent auditors is to continue to the point where the probability of material errors existing in the financial statements is low. The value of this point is based on judgement. This is certainly affected by the existing circumstances of the audit





regarding the extent to which external users rely on the statements and the likelihood of the audited organization to file bankruptcy.

#### 4. Types of Evidence

There are seven types of evidence used in audits:<sup>22</sup>

a. Physical examination -- inspection or count by the auditor of a tangible asset; e.g., cash, inventory.

b. Confirmation -- receipt of a written response from an independent third party verifying the accuracy of information requested; e.g., accounts receivable, sales transactions.

c. Documentation -- examination of records and documents to substantiate information in the statements.

d. Observation -- use of the senses to assess certain activities, such as evaluating inventory for obsolescence by checking for rust.

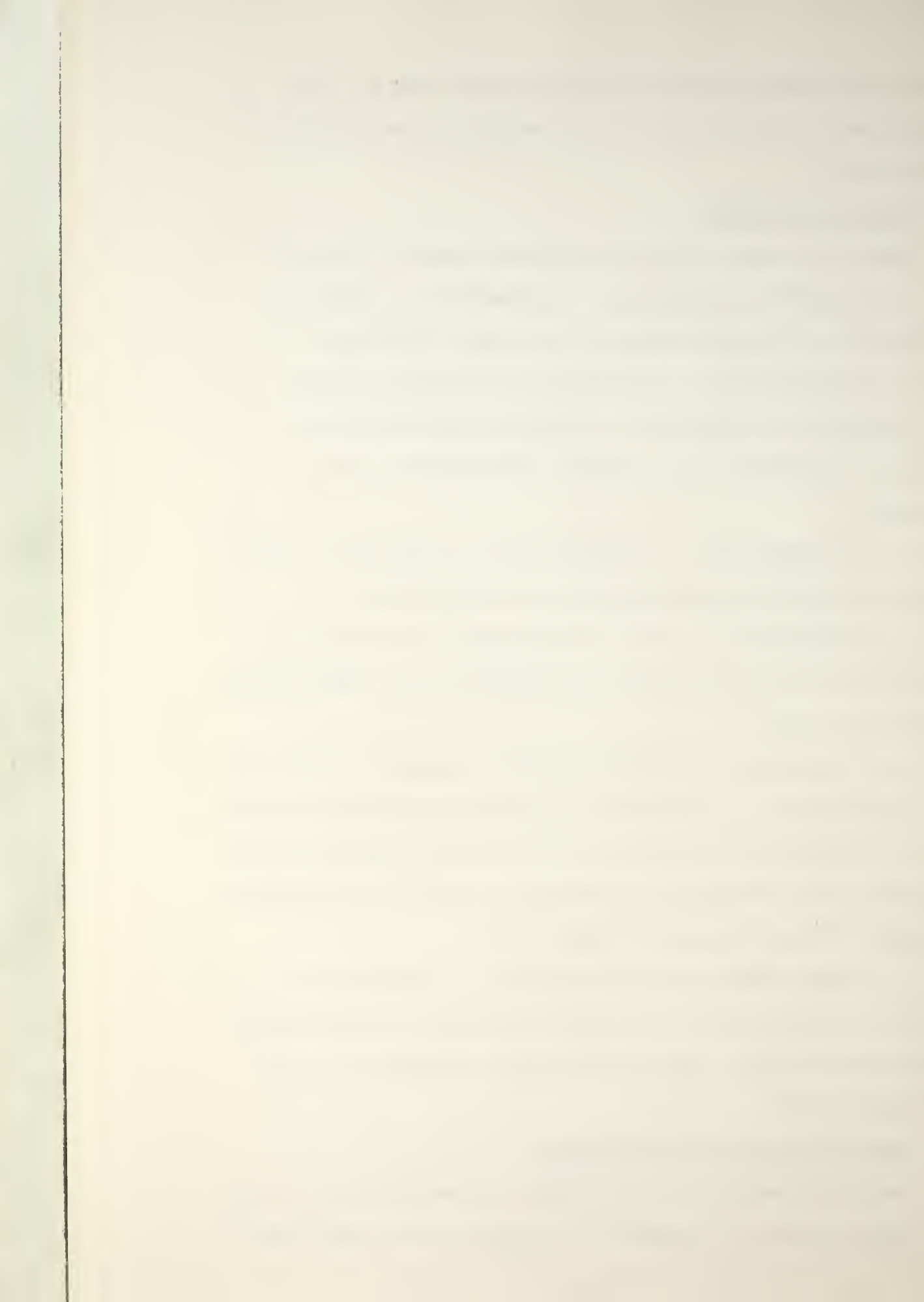
e. Inquiries -- written or oral information from the audited organization in response to questions from the auditor.

f. Mechanical accuracy -- rechecking a sample of the computations and transfers of information made by the audited organization during the period under audit.

g. Comparisons and relationships -- isolation of accounts or transactions to be more intensively investigated by use of calculations, such as particular expenses in different time periods.

#### 5. Overview of the Audit Process

An understanding of the overall investigation and the general audit process is helpful in acquiring the proper per-



spective of auditing. Figure 1 is a diagram of the overview of the audit process in the private sector.<sup>23</sup> This process includes:

- a. Obtain a general understanding of the client and its circumstances.
- b. Study and evaluate the system of internal control.
- c. Test the effectiveness of the system.
- d. Directly test the financial statement accounts.
- e. Complete the audit, combine the results of all the tests, and draw conclusions.
- f. Issue an audit report.

a. Obtain a General Understanding of the Client and Its Circumstances

To identify the unique characteristics that affect the collection of evidence, the auditor must understand the client and its circumstances. The general understanding includes four categories: (1) background information on the industry and business, (2) analytical tests to test the reasonableness of the financial statement balances, (3) legal commitments, including government regulations, to determine what is required by law, and (4) information collected to evaluate the possibility of management involvement in fraud.

b. Study and Evaluate the System of Internal Control

The importance of the audited organization's system of internal control in generating reliable financial information is one of the most widely accepted concepts in auditing. Internal control is defined by the AICPA as " ... the plan of organization and all of the coordinate methods and measures

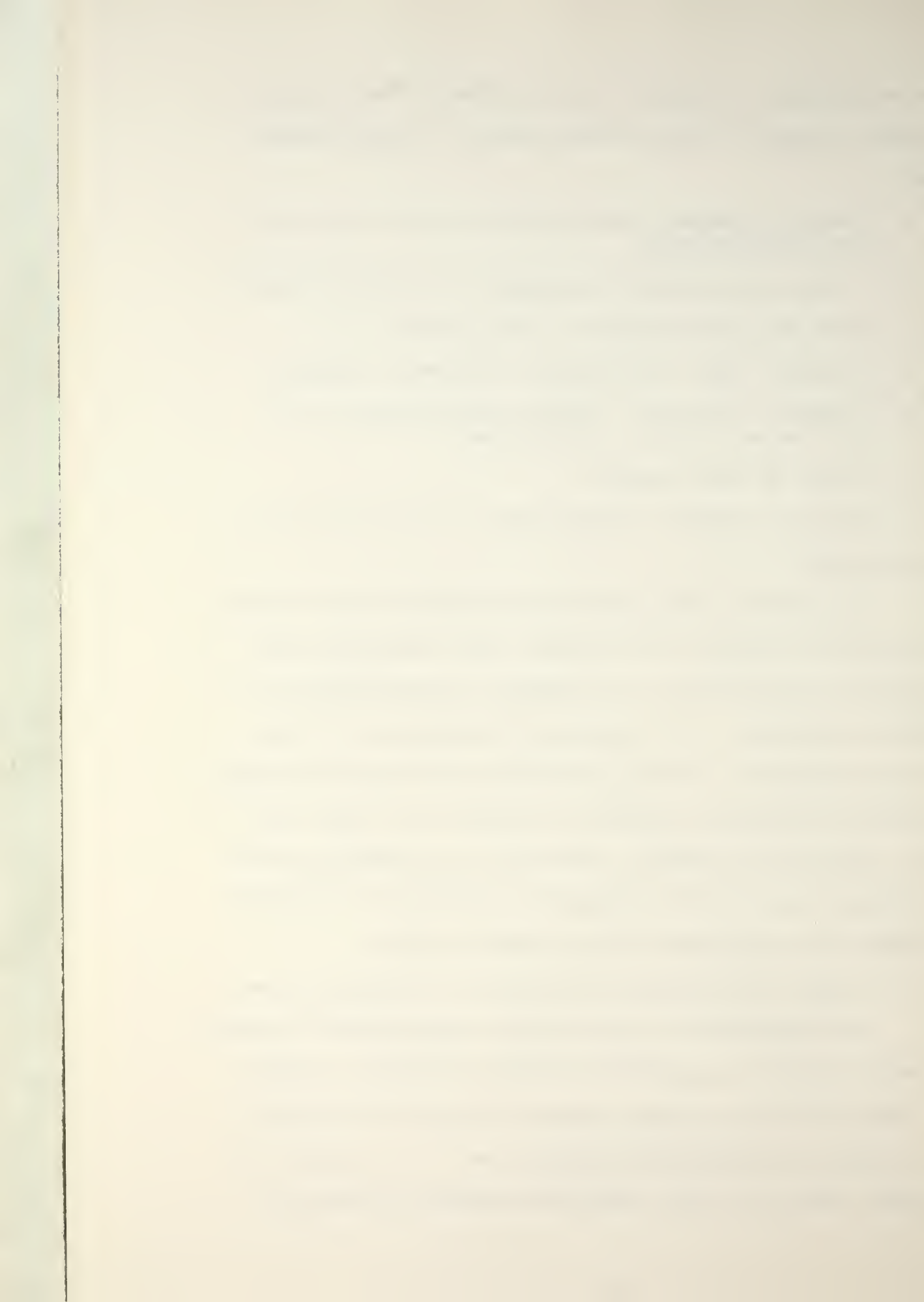
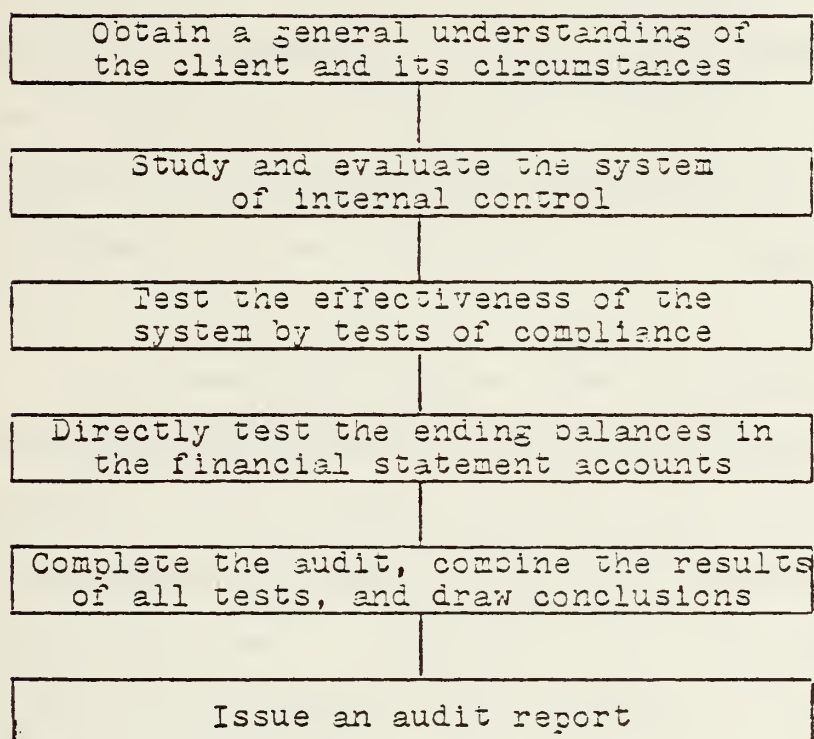


Figure 1 An Overview of the Audit Process



Source: Arens and Loebbecke, Auditing: An Integrated Approach



adopted within a business to safeguard its assets, check the accuracy and reliability of its accounting data, promote operational efficiency, and encourage adherence to prescribed managerial policies."<sup>25</sup>

The first step in evaluating an internal control system is to determine how the system works. The second is to make a preliminary evaluation of how effectively its objectives are accomplished, including an assessment of the strengths and weaknesses of the system. If after a review of the internal control system the auditor's level of confidence is high, the amount of evidence to be accumulated can be significantly reduced.

From management's view, the following are objectives of an internal control system: (1) to provide reliable data for decision making, (2) to safeguard assets and records, (3) to promote operational efficiency, and (4) to encourage adherence to prescribed policies. In complying with the second standard of field work, which concerns the evaluation of existing internal control, the auditor is concerned primarily with the first two of management's internal control objectives -- reliability of data and safeguarding assets and records for the purpose of fair presentation of financial statements.

Arens and Loebbecke have identified seven elements of an internal control system that are required if the four objectives of internal control are to be met.<sup>26</sup>





1. Competent, trustworthy personnel with clear lines of authority, which is the most important element since such personnel will perform with few other controls to support them while the opposite is not true.
  2. Adequate segregation of duties for the prevention of intentional or unintentional errors, such as separation of operational from record keeping responsibility, separation of custody of assets from accounting, separation of the authorization of transactions from the custody of related assets, and the separation of duties within the accounting function.
  3. Proper procedures for authorization for all transactions.
  4. Adequate documents and records.
  5. Proper procedures for record keeping.
  6. Physical control over assets and records.
  7. Independent checks on performance with an essential characteristic of independence from responsibility of preparation of the data, such as an internal audit staff.
- c. Test the Effectiveness of the System

When a control has been identified as effective by an auditor, he may rely on the control and consequently reduce the extent to which it must be tested. To justify this reliance, the effectiveness of the control must be tested using tests of compliance. These tests check if the control is applied consistently, applied properly, and that the person responsible for the control is independent of incompatible duties.

- d. Directly Test the Financial Statement Accounts

The balances of the different items in the financial statements should be verified by the various types of evidence available. If the auditor has obtained a reasonable

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level of confidence about the fair presentation of the financial statements through the general review of the internal control and tests of its effectiveness, the direct tests of balances can be significantly reduced. In all cases, however, some tests of the accounts are necessary.

e. Complete the Audit, Combine the Results of All the Tests, and Draw Conclusions

The auditor must combine with the direct tests of financial statement balances the results of previous tests, and any significant changes after the end of the period to form an overall opinion. This is a highly subjective process that requires professional judgement.

f. Issue an Audit Report

The audit report reflects the opinion of the auditor on the overall fairness of the presentation of the financial statements and is subject to some well-defined technical requirements as to specific content. Such requirements consider the independence of the auditor, the scope of the audit, compliance with and consistent use of generally accepted accounting principles, and unusual uncertainties affecting the financial statements.

6. Effect of Computer Systems on Auditing

The continual growth in the use of computers for accounting and financial applications makes an understanding of the impact of this use on auditing very important. The auditing concepts applicable to computer applications and those applicable to manual systems are the same, but the



specific methods to implement the basic concepts are different.<sup>27</sup>

The objective of the review of internal control in a system using a computer is the same as a manual system, which is to determine the audit evidence that should be collected on the basis of the adequacy of existing controls. A general understanding of the system is obtained from flowcharts, questionnaires, and error listings. Of the three, the only one unique to a computer system is the error listing, which is a list of the actual errors reported by the system. This supports the other two, since flowcharts emphasize the organization of the company and internal questionnaires emphasize specific controls without relating individual controls to one another. After the preliminary understanding is obtained, the relationship of non-computer controls must be evaluated relative to computer controls. When the auditor actually conducts the audit, he can audit around or use the computer.

Auditing around the computer is simply using the same procedures as in a manual system. This can be done when source documents are available in human readable form, the documents are filed so they can be located for auditing, and the output is detailed enough to trace individual transactions from source document to output and vice versa.

There are two well-known methods to test a system by using a computer. The first is the use of fictitious or test data on currently used programs, with the purpose of evaluating the capability to handle different types of transactions.





The second is the use of a separate program to process the same transactions on the same files to verify the original results. Another but more experimental method is the establishment of a separate entity with fictitious data to be processed with real data of the audited organization. The decision of which method to use is made by the auditor on the basis of professional experience.

## 7. Internal Auditing

Internal auditors are employed by management in a staff capacity to provide an organic audit capability. Arens and Loebbecke describe the difference between an internal auditor and an external auditor as the degree of independence possessed by the latter.<sup>28</sup> The Institute of Internal Auditors, Inc., (IIA) is more specific:<sup>29</sup>

Internal Auditing is an independent appraisal function established within an organization to examine and evaluate its activities as a service to the organization. The objective of internal auditing is to assist members of the organization in the effective discharge of their responsibilities. To this end, internal auditing furnishes them with analyses, appraisals, recommendations, counsel, and information concerning the activities reviewed.

In addition the responsibilities of internal auditors include providing information about the adequacy and effectiveness of the organization's system of internal control and the quality of performance. In an effort to assist internal auditors in the conduct of audits, the IIA has published "Standards for the Professional Practice of Internal Auditing," which are applicable regardless of the organizational environment.





a. Standards for the Professional Practice of Internal Auditing

The IIA Standards are arranged with five general Standards, each accompanied by specific Standards. The five General Standards include:

1.) Independence. Independence includes the mental attitude, as in the second AICPA General Standard of Generally Accepted Auditing Standards, but also includes organizational status. Internal auditing should be responsible to an individual in the organization that can insure independence in every aspect of the audit. In addition, the head of internal auditing should have direct communication with the highest level of management to assure independence and information flow. These conditions are made possible through the use of a formal written document defining organizational position, access to any required material/personnel, and the scope of the internal auditing activities.

2.) Professional Proficiency. This Standard includes the same considerations as the AICPA's first and third General Standards of the Generally Accepted Auditing Standards, which concern training, proficiency, and due professional care. In addition, it includes the first part of the AICPA's first Standard of Field Work relating to the supervision of audit work. The IIA's Standard includes the necessity of evaluating the scope of work to be done, the level of responsibility, and the technical skills required for audits to be performed. Included under supervision are the requirements



for authorizing and justifying deviations from approved audit plans, complete working papers, and accurate, timely reports.

Due professional care encompasses the use of the care and skill expected of a reasonably prudent and competent internal auditor. This includes being alert to the possibility of intentional wrongdoing, errors and omissions, inefficiency, waste, ineffectiveness, and conflicts of interest.

3.) Scope. This includes the examination and evaluation of the adequacy and effectiveness of the organization's system of internal control and the quality of performance in carrying out assigned responsibilities. Essentially, this includes the elements of the second AICPA Standard of Field Work and the second and third elements of the overview of the audit process shown in Figure 1. Particular emphasis is placed on management's objectives for its internal control system, as previously identified in the discussion on internal control.

4. Performance. Included in this Standard are the planning aspect of the first AICPA Standard of Field Work, the third AICPA Standard of Field Work relating to evidence collection, and the first, fifth, and sixth elements of the overview of the audit process reflected in Figure 1. This Standard also includes establishing audit objectives and scope of work, writing the audit program, discussions with audited management prior to issuance of a report regarding conclusions and recommendations, and the requirement for follow-up action to determine whether or not appropriate action is taken.



5.) Management. The first step in the management of internal auditing is insuring that top management establishes, with the formal written document discussed in Independence, the purpose, authority, and responsibility of internal auditing. Using this information, plans should be established to fulfill management's requirements and should include goals, audit work schedules, staffing plans and financial budgets, and activity reports.

Goals should be measurable and have specific criteria. Audit work schedule priorities should take the following into consideration: a.) the date and results of the last audit, b.) financial exposure, c.) potential loss and risk, d.) requests by management, e.) major changes in the area of concern, f.) opportunities to achieve operating benefits, and g.) capabilities of the audit staff.

Staffing plans and financial budgets include the number of auditors, technical capabilities required, and financial resources required. These plans should be determined from the work load required in internal auditing.

Periodically, activity reports should be submitted to top management comparing performance with goals and audit work schedules, and expenditures with budgets. Major variances and required action should be explained.

A final internal auditing requirement is to develop a quality assurance program to evaluate internal auditing operations on the basis of conforming to the Standards, the formal written document from top management, and other





appropriate standards. This is accomplished by continual supervision of all internal audits, periodic local evaluation of internal auditing, and external appraisals by qualified persons independent of the organization at least once every three years.

b. Additional Considerations

Lawrence B. Sawyer maintains that successful internal auditing is:<sup>30</sup>

... constructed on a foundation of technical excellence. But the structure must be firmly buttressed -- on one side by demonstrated acceptance and support at the highest levels in the enterprise; on the other by continued, imaginative service to management. Each of the two buttresses is an integral member of the structure. Let one weaken and the structure may tilt, ready to fall at the first hard blow from the winds of retrenchment and cost reduction.

Sawyer provides numerous tools and methods for attaining such a structure. Three such important tools, not previously discussed, are the drafting and use of audit manuals, use of audit programs, and preparing long-range programs. The first two are guides in the performance of an internal audit, while the third is an instrument with multiple applications.

1.) Audit Manuals. Audit manuals provide instructions and guidelines for the operation of the internal auditing organization. Such instructions can be divided into three groups: a.) technical functions, b.) administrative functions, and c.) miscellaneous functions.

The technical audit manual covers technical functions and provides a guide for the performance of an audit.





It includes all phases of the audit from objectives, theory, and scope to the use of audit programs and issuing reports. An example of the type of information included in such a manual (under the topic audit programs) might include the requirements for each individual audit program to be tailored to each assignment, and the need to determine operating objectives, the related required controls, and the details of the programs.

Another set of instructions needed to provide guidance for areas related to but not actually involved in the performance of internal audits is that covering administrative functions. Such items that are ordinarily included are instructions for office administration, personnel, audit projects, and audit reports. Instructions under audit reports might specify guidelines for interim reports, supervisory review of reports, and report distribution. The manual often takes the form of a compilation of staff memorandums.

In addition to the two previous types of functions, the third type includes all that do not fall in the other categories. These instructions may amplify, explain, or restrict statements in the other manuals or may cover areas not included in the other two. Such items as organization information, auditing methods and techniques used, report formats, and coordinating instructions are included under miscellaneous.

2.) Audit Programs. An audit program is a detailed plan of action for the actual conduct of an audit. The purpose



is to serve as a guide and control for an audit. It can be a pro forma type for functions that are substantially the same over a long period of time but are usually tailored for a specific audit. Each program should include the theory of the audit and should be able to determine if management's objectives are being carried out and whether adequate and effective controls exist that will provide assurance that objectives will be met.

3.) Long-Range Programs. A good long-range program serves many purposes. It can be used to spell out in detail the audits that are to be conducted, thereby simplifying resource requirements and insuring that no significant area is overlooked. It can be used as a justification for budget allocation. It can also be a valuable tool for justifying an increased staffing level.

All long-range programs should be approved by the policy-making level of management. This provides management with a preview of audit coverage in each area of responsibility, gives management opportunities to comment on scheduling and coverage, and when accepted, becomes a commitment by management.

Such programs also serve as standards for measuring audit performance, a control over the actual operating of auditing, and a notice to external auditors as to the operation of internal auditing within an organization.



4. Computer Auditing. If possible, the time for internal auditing to become involved with computer operations is during the acquisition process. Only at this time can the company's goals and objectives be related to the system that is incorporated. In addition, proper controls must be built into the system, not added on at some later date.

Additional considerations must be made concerning computer security and disaster control, as well as other controls, such as operational controls. The increasing dependence on computer systems subject organizations to greater losses or even "total corporate amnesia" in the event files are destroyed. These controls include such things as restricting access to the computer room and duplicate, vital records stored at protected, off-site locations. In addition, other types of controls, such as separating the personnel designing and programming from the computer itself, can reduce possible malfunctions of the system and improve its integrity.

Thus far, this discussion has included only concepts developed in the private sector. The next section discusses those concepts applicable to the public sector.

#### B. PUBLIC SECTOR -- THE FEDERAL GOVERNMENT

Auditing in the Federal Government is performed by the General Accounting Office (GAO) which reports directly to Congress. The authoritative compilation of GAO's basic policies, standards, and requirements for auditing and evaluating Government organizations, programs, activities, and





functions is published in its Comprehensive Audit Manual.<sup>31</sup>

The GAO Manual For Guidance Of Federal Agencies promulgates accounting principles, standards, and related requirements, and material for the guidance of Federal agencies in the development of their accounting systems and internal auditing programs; uniform procedures for use by Federal agencies; and regulations governing the relationships of the GAO with other Federal agencies.<sup>32</sup>

#### 1. Purposes and Objectives of Audits

There are two primary purposes of audits in the Federal government as defined in the GAO Manual for Guidance of Federal Agencies:<sup>33</sup> a.) to evaluate the efficiency, economy, legality, and effectiveness of Federal agencies, and b.) to assist Congress and Federal agency officials in carrying out their responsibilities by providing objective and timely information, including conclusions and recommendations.

Each agency is responsible for its operations, including management, development, and maintenance of adequate systems for accounting and internal control. In evaluating an agency, the GAO will conduct an examination in three broad categories:

- a. Financial operations and legal compliance
- b. Efficiency and economy of operations
- c. Program results

The financial operations and legal compliance audit is similar in some aspects to the private sector compliance audit in that a check is made to insure all legal requirements are met in an agency's operations. It is also similar





to the financial statement audit in that accounting systems and financial reports are evaluated.

Audits of efficiency and economy are the same as the operational audit. Here operations are evaluated also in the light of applicable laws and regulations.

Audits of program results relate directly to programs approved and funded by Congress. Programs are evaluated against established program objectives.

In evaluating these various categories, the GAO uses a basic audit approach.

## 2. Audit Approach

The following broad phases of work are used by GAO in conducting an audit:<sup>34</sup>

- a. Survey -- obtaining working information on the activity or program to be examined and checking for items that require a closer evaluation.
- b. Review -- detailed examination.
- c. Report -- communication of results, including recommendations.

The Survey phase includes gathering general working information, studying legislation applicable to the agency, and preliminary testing of management controls. The first two elements correspond to obtaining a general understanding of the client in the overview of the private sector process. In addition, preliminary testing is the same as the study and evaluation of the system of internal control in the overview.

The Review phase consists of detailed examinations in which emphasis is placed on reviewing and testing procedures, accounting systems, reporting, internal review, and other



elements of internal management control. This corresponds to the test of effectiveness phase of the private sector overview, as well as the direct testing phase. The Report phase is self explanatory.

### 3. Standards

The GAO in its Standards for Audit of Governmental Organizations, Programs, Activities and Functions has published a body of audit standards applicable to all audits in the government.<sup>35</sup> These standards include the Generally Accepted Auditing Standards published by the AICPA but include additional standards. The essence of these additions are discussed below.

#### a. General Standards

The audit of a government agency will include an evaluation of the three previously discussed types of audits in the government, financial and compliance, efficiency and economy, and program results. The scope of each audit should take into consideration the needs of the potential users.

#### b. Examination and Evaluation Standards

A review should be made of operational compliance with legal and regulatory requirements. This includes federal, and where applicable, state requirements and grant arrangements.

Included in the characteristics of a satisfactory system of internal control is the inclusion of an effective system of internal review, which corresponds to the Arens and Loebbecke seventh element of internal control of "independent



checks on performance." The GAO Standards do not define internal review but describe it as in the nature of management services assisting in supervising, advising, and reviewing designated functions. Internal review should be evaluated as a part of internal control to determine the degree of reliance justified by an auditor.

The GAO Comprehensive Audit Manual does not provide a specific definition of internal review, either, but it does provide a more detailed description by providing some basic principles and policies.<sup>36</sup> In this context, internal review refers to, from an agency perspective, an independent review, such as internal audit, of all other elements of management control. All types of review within an agency, including internal audit, should be coordinated and the work done by each clearly defined to prevent duplication of effort and jurisdictional disputes. It should be noted that this discussion relates to top management at the agency level.

#### c. Reporting Standards

Here the greatest differences between the private and public sector appear. In addition to the standards concerning financial reports, the GAO Standards require written audit reports for the arranging or requiring organization, officials responsible for action, others authorized to receive the reports, and where not prohibited by law or regulation, public inspection. These reports will be made on or before the dates specified by law.





Each report will be clear, concise, accurate, complete, fair, objective, and factual. Recommendations with emphasis on improvement and recognition of noteworthy accomplishments will be included. In addition, the scope and objectives of the audit will be explained, and a statement will be included covering the reasons for any omitted significant information.

A summary of these Government Audit Standards is also included in the GAO publication Internal Auditing in Federal Agencies.<sup>37</sup>

#### 4. Internal Auditing in Federal Agencies

The GAO Manual for Guidance of Federal Agencies includes guidance for internal auditing in the federal government.<sup>38</sup> The role of internal auditing is essentially the same as in the Private Sector, with emphasis on its function as a supplement to routine management checks on operations.

Virtually all the aspects of internal auditing as discussed in the Private Sector are covered in the GAO Manual with the following exceptions: a.) audit work schedules, b.) staffing plans and financial budgets, c.) activity reports, and d.) a quality assurance program. Even so, the conceptual validity and applicability to government operations is apparent.

In addition, the chapter in the GAO manual on internal auditing includes all the aspects covered in the section on auditing in the federal government. There is additional emphasis, however, on efficiency and economy and program





results audits. There is an emphasis on centralization of internal auditing at the agency level with a provision that a separate staff may be established at an organizational component of an agency. The central internal audit activity of the agency, however, should be accountable for furnishing general policy direction and coordinating the efforts of such a staff. The work of such a subordinate staff should be evaluated by the top internal audit activity. In addition, the coverage by the subordinate staff should be included in the scope of audit activity provided for top management.

#### 5. Effect of Computer Systems

As in the private sector, auditing objectives remain the same in audits of organizations using computer systems, but the procedures may be different. The GAO Comprehensive Audit Manual places emphasis on the examination of the functioning of the system and validation of data produced by the system.<sup>39</sup> Consideration should be given to the importance of the data in the organization's decision-making process and the risk involved in using inaccurate information. No specific methodology is discussed, but emphasis is placed on control procedures as part of internal control. These procedures are:

- a. Plan of organization and operation of the system
- b. Procedures for documenting, reviewing, testing, and changing and approving systems or programs
- c. Controls built into the hardware
- d. Control over access to equipment and files
- e. Application controls for tasks relating to input, processing, and output

All relate to the discussion of the private sector concept of understanding the systems, the computer controls, and non-computer controls.



The importance at the agency level of internal auditing as part of internal control was emphasized with the formal tasking of each executive agency head for establishment of appropriate internal audit by the Budget and Accounting Procedures Act of 1950.<sup>40</sup> The Department of the Navy has been upgrading its internal auditing since that time.



### III. INTERNAL AUDITING/INTERNAL REVIEW IN THE DEPARTMENT OF THE NAVY

"Regarding audit, the law places responsibility for the internal audit function under the Comptroller of the Department of Defense, requires each of the military departments to conduct internal audits in a manner consistent with that of the Comptroller of the Department of Defense ..."<sup>41</sup>

Additional authority for internal audits in the Department of the Navy was provided by the Budgeting and Accounting Procedures Act of 1950 in establishing appropriate internal audit as part of effective control over and accountability for all resources. The Naval Audit Service performs this function for the Department of the Navy (including the Marine Corps).

#### A. DEPARTMENT OF DEFENSE

##### 1. Audit Policies

The Department of Defense (DOD) Directive 7600.2, "Department of Defense Audit Policies," August 7, 1978, covers the establishment of the Defense Audit Service, updates audit policies, and clarifies organizational responsibilities.<sup>42</sup> In addition, it prescribes basic policies for internal audits for DOD and DOD Components. It provides that the basic criteria for both audit coverage and operations will be the Standards for Audit of Governmental Organizations, Programs, Activities and Functions, which were previously covered in the discussion on the Public Sector.





The directive further provides that the internal audit responsibilities for each Military Department, with the exceptions of Unified and Specified Commands, will be carried out by a single audit organization. This organization will report to the Department Secretary or Under Secretary and will receive technical guidance and supervision from the Assistant Secretary having financial management responsibilities.

Internal audit is identified as having the purpose of providing management with an independent, objective, and constructive evaluation of the economy, efficiency, and effectiveness with which managerial responsibilities are being carried out. It involves examining, evaluating, and reporting (including recommendations) on any area that has an impact on the use of all types of resources and the accomplishment of management objectives. Emphasis generally will be directed to determining that management controls are adequate in concept and effective in application.

## 2. Internal Audit

Expanded guidance for internal audit is provided in DOD Instruction 7600.3, "Internal Audit in the Department of Defense," January 4, 1974, over that given in DOD Directive 7600.2.<sup>43</sup> All internal audit responsibilities within each military department will be fulfilled by a single internal audit organization to assure independence and avoid duplication. In this regard, the terms "audit" and "auditing" cover a variety of activities, some of which are not considered as



part of "internal auditing" by DOD Instruction 7600.3. These activities include:

- a. Administrative examinations of transactions, vouchers, etc., which are part of regular operations of internal control.
- b. Inspector General and Procurement Management Review Program inspections and investigations.
- c. Technical surveys and inspections by various staff elements in performance of their normally assigned duties.
- d. Internal review at lower echelons.

In addition responsibility for audit of nonappropriated fund activities may be delegated to lower management levels.

a. Internal Audit Responsibilities, Mission, and Scope

Internal auditing is a staff function whose responsibilities include examining, observing, reviewing and evaluating all aspects of management for the purpose of reporting findings and making recommendations. Management responsibilities remain with management. The heads of internal audit organizations will develop and execute plans, policies, procedures, and programs necessary to discharge internal audit responsibilities.

Internal audit is the independent review and evaluation of the effectiveness and efficiency of management. It is an independent appraisal that is directed toward determining that management controls, practices, and procedures are adequate in concept and effective in application. It



should insure that such controls provide for adequate financial integrity and effective utilization of resources.

b. Audit Approach

Internal audit activities should be directed toward identifying, reporting, and making appropriate recommendations regarding conditions concerning inefficiency, deficiency, and errors. The primary consideration should be the prevention of deficiencies with secondary concern for detection of past deficiencies. Detailed examination will be limited to the extent necessary as revealed by appraisal of the system of internal control.

Contrary to the concept of auditing in the private sector, where the purpose is reliability of financial statements, the principal purpose of internal auditing ordinarily will be to appraise the effectiveness of management. If management controls and the accounting system are effective, reliance can generally be placed on the financial statements produced.

3. Internal Review

"Management at lower echelons is not precluded from establishing groups which, while not performing independent or comprehensive audits, would serve as 'troubleshooters' who make special analyses in comptroller and other areas and assist in correcting deficiencies which are revealed by audits, reports, analyses, observations or other means. In authorizing such internal review activities at any echelon, care should be exercised to assure avoidance of duplication of





internal audit functions as defined below which are assigned to the centralized audit organizations."<sup>44</sup>

The above quote and the internal audit functions to which it refers are included in Appendix A. The precise meanings of the term "internal review," its appropriate elements and relation to internal auditing are presently under debate and a matter of controversy, as is the meaning of "duplication of internal audit functions."<sup>45</sup>

A draft copy of the Study of the Operations and Relationships of Audit, Inspection and Review Groups in the Department of Defense of 3 November 1978 by the Department of Defense Joint Study Group on Audits, Inspections and Reviews reveals some of the complexities involved.<sup>46</sup> The study of internal review was from the perspective that the only activities authorized were strictly limited to special analyses in comptroller and related areas and assisting in correcting deficiencies discovered by means other than internal review. The study found that there was no common understanding of the meaning of internal review and concept authorized by DOD Instruction 7600.3. The fourth alternative provided by the study was to clarify DOD policy to explicitly define and limit the functions of internal reviewers. This alternative was not recommended, because local commanders need to have professional auditors available and the Army and Navy had not followed DOD audit policy in the past. The study found that the Marine Corps was at that time following





policy and did not duplicate the work of the Naval Audit Service but did not meet audit standards. The Army was found to produce the highest quality work of the services with internal review but duplicated the type work of the Army Audit Agency. The two recommended alternatives were to consolidate existing internal review assets with the internal audit organization or authorize internal reviewers to function as local internal auditors by revising DOD policies. The first alternative was preferred due to the advantages of centralized control.

Within the framework established by the first paragraph in this discussion of internal review and surrounded by the lack of common understanding of the meaning and concept of the functions of internal review activities authorized by DOD, the Military Departments were to establish internal review, if desired.

#### B. DEPARTMENT OF THE NAVY

In accordance with policy established by DOD, the Naval Audit Service (NAVAUDSVC) performs the internal audit function for the Department of the Navy as directed by the Navy Comptroller (NAVCOMPT) Manual Volume I. This directive also designates internal review as a responsibility of Command to be performed at all installations.<sup>47</sup>

##### 1. Internal Audit

The Secretary of the Navy Instruction (SECNAVINST) 7510.7A, Department of the Navy Audit Manual for Management,



28 December 1978, prescribes policies and procedures for the management of audit in the Department of the Navy.<sup>48</sup> The stated purpose of internal audit in the Department of the Navy is the same as that which is established by DOD Directive 7600.2 and DODINST 7600.3. This is to be accomplished through objective reports, constructive recommendations, and consultation for management in planning action on findings and recommendations. This emphasis on assistance to management has resulted in the Secretary of the Navy (SECNAV) policy to conduct internal audits on a mission-oriented basis. That is, every aspect of each audit is to be guided by the mission of the audited organization, so that those functions of primary concern to management at all levels will receive audit attention. In addition, supplementary coverage is provided by fiduciary-type audits, such as disbursing and commissary stores, and Morale, Welfare, and Recreation fund activities. The same auditing principles, policies, standards, and procedures that apply to internal audit also apply to internal review.<sup>49</sup>

## 2. Internal Review

The policy and guidelines for Internal Review in the Department of the Navy are prescribed by SECNAVINST 7510.8, "Internal Review in the Department of the Navy," 15 October 1976. It is the policy of the Secretary of the Navy that Internal Review, as a fundamental element of comptrollership, be implemented to insure proper administration and utilization of resources.<sup>50</sup>



a. Definition and Discussion

"Internal Review is the conducting of special audits, studies, analyses and investigations of financial operations and the use of command resources to detect deficiencies, improprieties and inefficiencies, and to provide recommendations in order to correct conditions that adversely impact on financial management, mission accomplishment, or the integrity of command."<sup>51</sup>

This definition adds to the uncertain discussion of internal review in DODINST 7600.3, which was previously discussed. "Special analyses" have been expanded to include "special audits, studies ... and investigations." Internal review also now includes detection of deficiencies in addition to their correction. The DOD discussion includes " ... care should be exercised to assure avoidance of duplication of internal audit functions ..., "<sup>52</sup> while SECNAVINST 7510.8 states "Internal Review may complement but not intentionally duplicate the responsibility of centralized audit organizations such as the Navy Audit Service, and as first priority should always serve command."<sup>53</sup> In addition, guidance is added that reviews should be independent, thorough, professional, and detailed so that duplicative reviews by auditors external to the command can be minimized.

Resources for performance of internal review will be made available from within available resources. Planning will be subject to semiannual command review and approval insofar as practical. Also, various headquarters' elements may issue supplementary guidance to subordinate commands to insure compliance with SECNAVINST 7510.8. Flexibility will





be planned so special reviews can be scheduled to be responsive to special circumstances.

b. Functions

Internal review will normally be implemented at a field activity by the Comptroller for the Commanding Officer. "Internal Review will be responsible for examining internal management controls, practices, and procedures at all levels to determine adequacy in concept and effectiveness in application."<sup>54</sup> This is almost an exact repeat of the description given of internal audit in DODINST 7600.3.<sup>55</sup> Both also include the need to provide for financial integrity and effective use of resources. Included in the SECNAV instruction are:

- 1.) Audit of civilian timekeeping and payroll and certain nonappropriated funds.
- 2.) Monitoring correction of deficiencies revealed by agencies external to the command.
- 3.) Monitoring and evaluating financial/accounting systems and procedures with emphasis on audit trails and other management controls.
- 4.) Designing and using audit check lists unique or critical to the command in safeguarding resources.
- 5.) Review controls and changes for resource accountability.
- 6.) Participate in reviews of other problem areas.
- 7.) Maintain liaison with external audit/inspection agencies.

c. Staffing

Successful implementation of Internal Review requires competent, experienced personnel on a permanent or



ad hoc basis, depending on the needs and characteristics of the command. Local staffing and training criteria should include:

- 1.) A nucleus consisting of an interdisciplinary group with financial management skills and the dominant technical skill represented by the command.
- 2.) The specific staffing requirements should be based on the needs and characteristics of the command. At present, there are no objective criteria provided or available to determine what appropriate staffing should be.<sup>56</sup>
- 3.) Since Internal Review provides an invaluable training ground for development of future financial management talent, training should include not only auditing but areas of management interest. Training course and materials are the responsibility of the Auditor General of the Navy.

d. Audit Process

The Introduction to Navy Audit and Internal Review Text addresses the conduct of an audit as related to internal review.<sup>57</sup> Time constraints and staffing will determine the scope and type of review conducted, but to some extent, every audit process should address the following.

1.) Audit Planning and Scheduling. Annual plans should be made by soliciting audit proposals from the various departments of the activity. Proposals should be identified as to type of audit required and priorities assigned. Man-hour estimates should be made and the plan prepared, with any proposals left over kept in a deferred status. The plan should be published and distributed to all concerned.



2.) Opening Conference. This is a meeting to convince management of the value of the upcoming review and to acquire various types of background information, such as organization, policies, etc. This corresponds to a segment of the Survey Phase of the GAO approach and background information of the overview in the private sector.

3.) Activity/Area Designated for Audit. This is defining the audit environment to aid in preparation of the audit. This can be characterized as an addition to the Survey and overview discussed above.

4.) Preaudit Survey. The objective of the survey is to identify areas requiring close audit examination, determine areas that generally appear satisfactory so that unnecessary coverage can be avoided, and develop specific audit plans and objectives. The auditor is concerned primarily with evaluating management controls and ways to improve them. This corresponds to the preliminary testing in the GAO Survey Phase and the study and evaluation of the system of internal control and test of effectiveness phases in the Private Sector overview.

5.) Audit Program. Audit programs in this case are the same as discussed in the section of internal auditing in the Private Sector. They are standardized checklists for specific functional areas and are particularly helpful to inexperienced auditors but are not substitutes for judgement. The Naval Audit Service has developed an extensive list of such programs.



6.) On-site Examination. This is the actual conduct of the audit, which corresponds to the GAO Review Phase and the Private Sector overview Direct Test Phase.

7.) Working Papers. Working papers are a constructive, historical record of all parts of the audit performed and must be complete.

8.) Findings. Clear, correct, concise, and convincing findings constitute a significant factor in the success of any audit, as noted in the Government Standard of Reporting. Figure 2 is a schematic that succinctly presents the key elements.

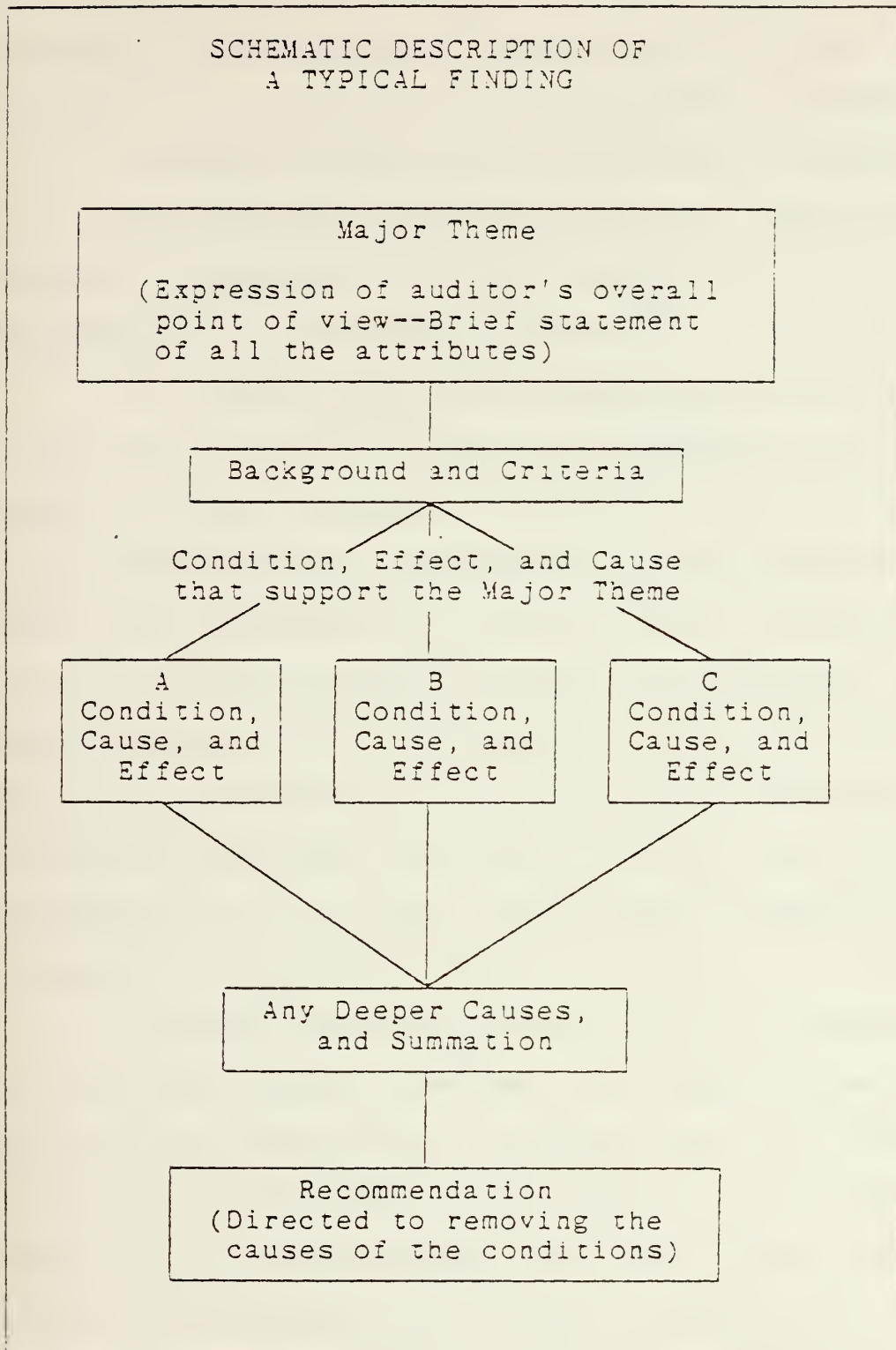
9.) Audit Utilization. Audit utilization refers to the process of insuring that management uses the results of the audit. This is accomplished by discussing with management any significant findings at the time of their discovery, as well as a review by the audited organization of the draft report. This review is to verify facts supporting the findings, determine preliminary action taken, if any, and determine planned action and target dates.

10.) Audit Report. The report is the formal record of the audit distributed to local management. In addition to the findings, it should include a.) statements of concurrence or nonconcurrence by audited management with findings and recommendations, b.) actions taken, c.) actions planned with target dates, and d.) when applicable, items of dispute, including the position of the department head or a statement that an item requires action by higher authority.





Figure 2



Source: AUDGENAV, Introduction to Navy Audit and Internal Review



SECNAVINST 7510.8 requires that all internal review reports be submitted to the Commanding Officer via the intermediate managers and that an effective followup program is needed.

e. Internal Review in the Marine Corps -- Differences

At the present, Marine Corps Order 7540.2, "Internal Review," 27 September 1976, is in effect but will soon be superceded by Marine Corps Order 7540.2A.<sup>58</sup>

The present Order is concerned with financial resources and the financial management responsibilities of commanders to insure commitment of resources in accordance with prescribed statutory requirements and policies and procedures of the Commandant of the Marine Corps. In addition, it does not include as many procedures and guidelines. The following discussion will be concerned with the new order. Changes in requirements will be noted, as will differences with previously discussed directives. The new order references SECNAVINST 7510.8, which was published subsequent to the issuance of the present Order.

Internal review will soon include the assessment of the use of all command resources; e.g., appropriated funds, command property, materials and supplies, which is a change. Internal review staffs will provide support to all installation activities and organizations, including tenant organizations without an internal review staff. Emphasis will be on the effectiveness of internal controls and recommendations for the correction of deficiencies, the latter of which is



an additional emphasis. Subsequent to corrective action, a follow-on review shall be conducted to insure conditions have been corrected. The submission of an information copy of the annual internal review program to Headquarters has been changed to within 45 days of the end of the fiscal year vice formulation. A copy of command directives, or revisions, implementing the new order will be submitted to Headquarters.

1.) Audit Liaison and Followup. Detailed information is provided concerning matters relating to audits/reviews by agencies external to the command.

2.) Constructing the Annual Internal Review Program. Program development will include revalidated projects from the previous period with a high priority, such as those revealed by an audit of an agency external to the command. Staff and subordinate elements should also recommend projects, as noted in the Navy Audit Process. Sufficient time will be reserved for follow-up reviews to insure corrective action has been taken. A portion of the manhours available will be reserved for urgent unforeseen requirements, not to exceed 20 percent of the estimated manhours available (the 20 percent is a new limitation). The program will include as a minimum: a.) requesting staff office and point of contact (a new requirement), b.) reason for review, c.) objectives and scope of review, d.) summary or checklist of procedures, e.) milestones and estimated manhours, and f.) previously noted deficiencies. A new requirement is for the





comptroller to forward the proposed annual program, with recommended priority ranking, to the Commanding Officer for approval. (SECNAVINST 7510.8 designates a semiannual review and approval by commanders, insofar as practical.) Consideration should be given to areas outside comptroller functions. Also new is an encouragement to forward to Headquarters a copy of completed internal review reports, especially those with Marine Corps-wide application.

3.) Performing the Review. The Preliminary Actions prescribed correspond to the Navy Preaudit Survey, GAO Survey, and the background and preliminary testing in the private sector overview plus a requirement to evaluate personnel available for the review. When needed, the comptroller should request augmentation by functional or technical personnel within the command. The performance of the review corresponds to the review, examination, and direct testing previously discussed. Documentation is emphasized, and detailed instructions are given for reporting the results in a formal manner (a new requirement). The report should include a selection of alternatives so the commander has the greatest degree of latitude and should be issued no later than 30 days after completion of the review. It is the responsibility of the comptroller to insure the commander is apprised of internal review results.

4.) R.S. 3679. Detailed information is provided regarding administrative control of appropriations (a new section).



5.) Timekeeping and Civilian Payrolls. Guidance is provided regarding the conduct of the review required by NAVCOMPT Manual, Volume I, and assigned to internal review by MCO 7540.1.

The staffing of internal review will be from within available manpower authorizations and funding. A report will be made to Headquarters, with the annual internal review program, providing the rank/grade and military occupational specialty/series of authorized and assigned positions in internal review. At the present time no criteria have been established to determine staffing requirements; rather, staffing is determined at present by the workload planned and performed by the internal review function.<sup>59</sup>

Internal auditing is stressed in DOD, and internal review is "mentioned." In the Department of the Navy, internal auditing has been continually emphasized. Internal Review is now emphasized, though only recently. The growth of Internal Review has been the result of an effort to provide commanders with an increased review capability over that provided by the Naval Audit Service every 3 to 5 years, depending on the command.<sup>60</sup>



#### IV. CASE STUDY -- MCAS

##### A. THE AIR STATION

The Marine Corps Air Station (MCAS) supports both tenant and transient aviation units and detachments. In addition to the 5 tenant aviation units, the MCAS provided support for 34 rotational units with 552 aircraft and 7,574 personnel during the last fiscal year. An additional 16,704 transient aircrewmen stopped at the MCAS for services.

The Fiscal Year 1979 budget for the MCAS totalled over \$48 million, including just over \$11 million for Station Operation and Maintenance, Marine Corps, funds. The commanders of scheduled rotational units are expected to provide around \$5 million for anticipated aircraft maintenance support. (See Table I)

##### B. INTERNAL REVIEW

Internal Review was established in June 1976 as a training billet. That is, an Auditor Trainee, GS-510-05, was hired and entered a 24-month training program. Subject to evaluation at 6-month intervals, the trainee was scheduled to advance to GS-07 at the end of 12 months and subsequently to GS-09 after 24 months. Training was to be on the job and guided by the Deputy Controller.

###### 1. Organization

The Internal Review function at the MCAS has been organized as a division of the Comptroller Department, as



Table I  
MCAS Budget Distribution  
FY 1979

	FY 1979 <u>AUTHORIZATION</u>
Operation & Maintenance, Marine Corps	\$11,619,530
Family Housing Defense	2,164,269
Total Other Reimbursements*	<u>5,640,802</u>
Grand Total Expense Operating Budget	\$19,424,601
Total Miscellaneous Allotments	881,408
Marine Corps Stock Fund	\$ 3,325,000
Marine Corps Trust Funds	131,350
Navy Stock Fund	<u>24,349,294</u>
Total All Funds	<u>27,805,644</u>
Overall Grand Total	<u><u>\$48,111,653</u></u>

\*Includes \$5 million for maintenance support of rotational units.

Source: MCAS FY 1979 Budget





shown in Figure 3. The job description includes the conduct of periodic and special efforts to evaluate the effectiveness of the Station financial management systems, as well as all phases of their installation. It also specifies responsibility to review accounting procedures, recommendations on organization and staffing in the Comptroller's Office, the maintenance of funds allocated to the Comptroller's Office, plus liaison duties with external agencies. An additional duty to select and prepare Cost Reduction submissions is also assigned. No official local directive assigning responsibilities to Internal Review has been published, but letters of appointment are drafted for such functions as the audit of funds issued to Imprest Fund Cashiers. The Audit Verification Board, composed of one officer and the one member of internal review, was established for such audits as the cash count in Disbursing and audit of subfunds.

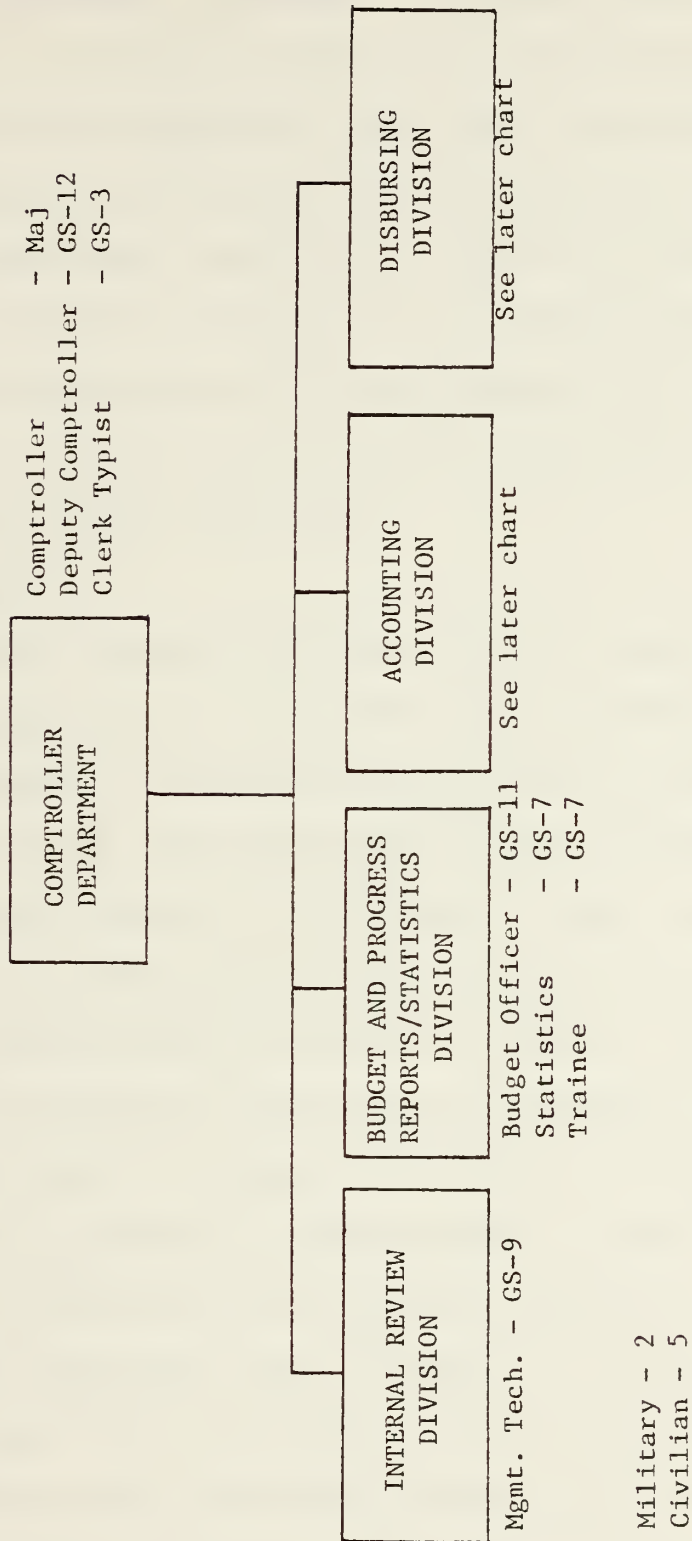
## 2. Staffing

The first trainee to hold the internal review position left the job after about a year for other employment. His replacement holds the position today as a GS-09. Before coming to this job, the incumbent worked for 18-1/2 years as an internal auditor for General Electric. He has an accounting degree and has expressed an eagerness to pursue every opportunity to increase his effectiveness. The Internal Review Division has a recognized requirement of two personnel but to date has only one person assigned. (See Appendix D.)



Figure 3

Comptroller Department Organization





Appendix P is the training plan established to fulfill the training program previously discussed. The training is financial management oriented. It covers Accounting Division operations, budgeting at the cost center and station levels, Comptroller Department operations, including the financial section of the Public Works Department, Cost Center management, and Supply operations. Evaluations are provided at six-month intervals and sent to the Comptroller. In addition to completion of the training program, the incumbent spent six weeks in 1977 with an audit team of the Naval Audit Service, learning audit routines.

### 3. Program

An annual Internal Review Program is required by MCO 7540.2. Appendix C is the MCAS report on the Fiscal Year 1979 Program. It has been constructed to comply with MCO 7540.2 and with the guidance provided by DODINST 7600.3 to avoid the duplication of the internal audit functions. The Program was constructed by first identifying reviews required by higher authority, such as audit of Imprest Funds. Then projects proposed by the various departments in the activity were added. A reserve of manhours was scheduled for unforeseen problems ("troubleshooting" capability).

A large portion of the reviews scheduled and performed are the fiduciary type. Appendix D is the report of reviews for the first six months of Fiscal Year 1979. The remaining reviews are concerned primarily with financial





management issues, both those performed and scheduled. During an approximate two-month period this past budget cycle, the internal review incumbent spent most of his time assisting in the zero base budget construction. This provided training for him and filled a manpower need in budgeting. The "As Assigned/Required" part of the scheduled program absorbed the loss of manhours. The "troubleshooting" assignments that have been performed include an investigation concerning the difficulty in obtaining cable for the runway arresting gear. This represents an immediate response capability for the commander to changing conditions.

#### 4. Approach to the Conduct of a Review

As discussed in the previous section, the areas for reviews to be conducted are established by the Commanding Officer, requests from departments, or as directed by higher authority. These reviews have historically been almost exclusively financial management or fiduciary oriented.

The first step in a typical review is the research of pertinent directives to determine what checks of compliance need to be made. A list of points to check is made to use in the same way an audit program is used for audits of the civilian payroll. Then, personnel who are part of the area being reviewed are interviewed and observed. Specific points of compliance are noted, as are additional problems that arise.

When the review covers an area with detailed documentation, such as vouchers, a system is devised to test the



transactions. For areas that involve only a few items, such as about 40, a census is made. The approach for areas with a large number of transactions, however, involves sampling about 20 to 25 percent of the population, depending on the reviewer's judgement. A typical procedure would be to inspect every fourth document. When a discrepancy is noted, a larger sample or census is taken. As an example, during a recent verification of cash held in Disbursing, a several hundred dollar shortage was discovered, and every document processed by the section for the period of time since the last verification was traced through the system. The case is still under investigation by authorities. Such verifications of cash balances are done on an unscheduled basis to improve the representativeness of the count. The Internal Review incumbent has been involved in the actual counting of cash.

The majority of the reviews now conducted concern the computer reports generated by the automated accounting system for appropriated funds. Since the automated system has been installed, control over obligated funds has been improved. However, there has been a continuing problem of differences in the records of the requisitioning activity, supply, and accounting. In addition to the normal document flow, the use of telauto-writer equipment has further aggravated the problem, because quite often the originator receives notice of a cancellation but the accounting section does not. This presents a significant problem at the end



of the fiscal year. For these reasons, Internal Review spends a considerable amount of time researching such problems. Appendix E is the report for just such a review. The results show that efforts during the review were directed at obtaining a status of funds with recommendations concerning future actions regarding the status of funds. Another recent review resulted in clearing over \$1 million from the books, providing a significant reduction in the amount of associated paperwork. One of the major problems concerning the differential in records of various departments, which was not explicitly identified in the report, is the problem of personnel turnover at the document-generating level of the various departments. This situation requires a constant retraining process that is accompanied with associated errors. This problem has been addressed by numerous meetings of management to attempt to produce a solution.

Another type of review that is common is the conduct of research to determine the effect of changes in codes used to account for funds. This information is then used to reconcile the department's records with those of accounting. Here again, personnel turnover appears as a problem in terms of knowledge and experience.

The reporting of the results of the internal reviews performed is primarily on an informal basis. Affected management is briefed with the information produced by the review. The Comptroller is made aware of the results as well, and the Comptroller determines whether the results are





significant enough to brief to the Commanding Officer. Due to the shortage of administrative support available, the written reports are usually in memorandum form addressed to the Commanding Officer and delivered to the Comptroller. The review report in Appendix E reflects the types of reviews that have been discussed. The information, as previously mentioned, is primarily the current status of funds with some discussion of problems in a general context. Several alternatives are presented to provide the Commanding Officer with latitude in the decisions that are required.

The followup procedure for reviews is informal. That is, if the problems identified in the review occur again, Internal Review makes note of it by comparison with records within Internal Review. Liaison is then made to determine why.

Service to management is the philosophy of MCAS'S Internal Review. If the status of funds is known, decisions regarding items with significant financial impact can be made with a better anticipation of the effect on the budget. Control over the budget in turn will allow management to concentrate on performing the assigned mission.

The next chapter will concentrate on the following points to reinforce Internal Review's capability to provide service to management:

1. Policy changes required to provide the Internal Review capability required by management.
2. Emphasis on command support for Internal Review in terms of independence, staffing, and an implementing directive.





3. Need to formalize the planning, reporting, and followup procedures.
4. Requirement to expand the scope of Internal Review and include the requirement to meet GAO Standards whenever possible.



## V. CONCLUSIONS AND RECOMMENDATIONS

### A. POLICY FOR INTERNAL REVIEW

The GAO views internal review for government agencies as an independent review, such as internal audit, of all elements of internal control. It not only should review internal control but should also be an element of the internal control system. As such, it should be evaluated by an external audit agency to determine its reliability.

The DOD conception of internal review is somewhat more restrictive. At present, the precise definition, intent, and methodology of internal review in the DOD is uncertain. From the DOD perspective discussed in Chapter III, it appears that centralized control is a major consideration of any internal audit function as stated in DODINST 7600.3 and the report by the DOD Joint Study Group. Concerning internal review, the report of the Study Group contains the statement that most internal reviews examined did not meet GAO audit standards and thus were deficient. The statement that internal reviews should meet audit standards implies professional audit capability should be maintained at every field activity. The important point is that a quality review staff should be maintained for a very limited function; e.g., "trouble-shooting." As also discussed in Chapter III, it is interesting to note that the agency that met DOD guidance regarding the care in avoidance of duplication of internal audit



functions did not produce quality results. On the other hand, the agency that duplicated such functions produced a much higher proportion of reviews conducted at acceptable levels of performance.<sup>61</sup>

In SECNAVINST 7510.8, the Department of the Navy has been more specific in its definition of and guidance for internal review. It is to be a special capability, including audit, that does not INTENTIONALLY duplicate internal audit functions. Reviews that are conducted, however, should produce reviews of such quality that external auditors can reduce to a minimum the number of duplicative reviews that have to be made. The soon-to-be promulgated MCO 7540.2A emphasizes review of internal controls and providing corrective recommendations.

If a commander is to maintain a review capability that will improve both the effectiveness and efficiency of mission performance, it seems apparent that it should be more than just a limited "troubleshooting" ability as it appears that the DOD Instruction prescribes. The SECNAV Instruction and MCO establish a more comprehensive capability. However, both of the latter instructions require that funding of this capability must be made available from available resources. This places the burden of funding on the local commander, who must take a reduction in another area to fund Internal Review. This raises the question of the value of Internal Review. How much is enough, and how much should Internal





Review cost? Since no guidance is provided, those difficult questions now have to be answered at the operating level and have resulted in staffing problems.

## B. CASE STUDY

Since the Department of the Navy approach to internal review offers a better tool for a Commanding Officer to review his command, this approach will be used when considering the case.

Internal Review at the MCAS complies with the intent of MCO 7540.2. The reviews performed primarily pertain directly to the financial resources and financial management responsibilities of the Commander. The following will discuss the effect of the new MCO 7540.2A and SECNAVINST 7510.8.

At present, the reviews conducted concern financial resources or fiduciary responsibilities. When MCO 7540.2A becomes effective, the emphasis of internal review will include the efficient and economical use of all command resources, as does SECNAVINST 7510.8. Both of these directives include the formulation of recommendations to correct the conditions that have an adverse impact. The recommendations provided in Appendix E relate to the status of funds, not to the correction of the conditions that caused the problems.

### 1. Organization

Internal review at the MCAS is implemented under the Comptroller as required by both directives. However, both



directives provide for obtaining functional or technical personnel from within the Command to augment the nucleus of Internal Review. At present, the MCAS uses only the incumbent, except for fiduciary audits when one officer is used. Internal Review is placed under the Comptroller, which limits the independence of the Internal Review function. The Comptroller administers the Internal Review Program and filters all reports produced. Since most all of the reports are informal, the Comptroller decides what results the Commanding Officer should receive.

## 2. Staffing

The experience level and training of the incumbent is impressive. The training program has included the elements mentioned in SECNAVINST 7510.8 for training for financial management, but should also provide for the expanded concern for efficiency and effectiveness. The staffing level at present is based on the limited scope of internal review as provided in the current MCO. Even so, if the incumbent were to leave, Internal Review, under present arrangements, would begin all over with a GS-05 under training. Also, if the more comprehensive Internal Review is to be implemented, it does not appear that one person will be able to cover all requirements since the incumbent has a full schedule with the present limited scope.

## 3. Program

The new MCO will require a more formalized approach to the construction of the annual program. The contents of



the report to CMC will be expanded, and the role of the field activity Commander in the decision making process of program content will include evaluation of projects with assigned priorities. Emphasis in both the MCO and SECNAVINST includes the examination of the system of internal control for concept and application, which will have an effect on the projects planned. The new limitation of 20 percent by the new MCO on the amount of reserve manhours should have little effect at the MCAS since currently only 23 percent is scheduled.

#### 4. Approach to the Conduct of a Review

Internal reviews performed to date have had a specific purpose in mind; e.g., status of funds or effect of system reporting on funds. The SECNAVINST and MCO require a more comprehensive approach. The SECNAVINST provides guidance that reviews should be independent, thorough, professional, and detailed so that duplicative external reviews by external auditors can be minimized. To accomplish this, internal reviews have to meet the GAO Standards for internal audit. The reviews conducted have followed the general audit process but were not intended to be as inclusive as that required to meet such standards.

Some examples of the differences that will be required are the objectives of some types of reviews and the sampling methods used. The status of funds is obviously important, but if there is a continuing problem as in the MCAS automated reporting system, reviews should include attempts to isolate the problems and provide recommendations regarding



the correction of the problems. As for sampling, judgement samples are appropriate but should be based on some criteria other than every fourth document, the latter of which may be appropriate for a limited-objective review.

Additional changes that will be required are the changing of both the reporting and followup procedures from informal to formal. It should be recognized that as a system becomes more formal (such as the program, reporting, and followup), more administrative support will be required.

### C. RECOMMENDATIONS

#### 1. Policy

a. The apparent differences in the concept of internal review at the DOD and Department of the Navy levels must be resolved if internal review is to produce the quality of work desired by the DOD Study Group and by the Navy to reduce duplicative audits.

b. In addition, provisions must be made at the agency level for the resources that will be required in the actual implementation of internal review as a functional component of the system of internal control. Resources must be used to protect and insure the effective, efficient use of a much greater amount of resources.

c. In addition, staffing criteria must be established in terms of numbers of personnel and skills required. The present method of judging the personnel required to execute the programs currently in effect will not produce quality Internal Review.





d. Long range programs need to be developed to assist field activities in developing Internal Review Programs. Such programs would insure all appropriate areas are scheduled for review and would provide justification for the resources required at the operating level.

## 2. Case Study

a. In order to make internal review effective as part of the system of internal control, the Commanding Officer must be convinced of its value and effectiveness by being closely involved with the growth of the program. The program should be specially tailored to the needs of the command based on the mission to be performed and known or suspected critical areas of concern.

b. A directive should be initiated, similar in function to the formal written document in the Private Sector, establishing the independence, purpose, authority, and responsibility of internal review in implementing the provisions of MCO 7540.2A (a copy of which is required to be forwarded to CMC).

c. Even though both the SECNAVINST and MCO require that Internal Review be established under the Comptroller, a requirement for formal reporting to the Commanding Officer and regular briefing by Internal Review will improve the INDEPENDENCE of the Division, which is required by GAO Standards, and will also demonstrate command support.

d. The Head of Internal Review should have the ability to draw knowledgeable, experienced personnel from



the functional/technical areas under review. This will provide the manpower to perform routine tasks, such as counting cash, so the Head of Internal Review, a GS-09, can spend his time in more productive work, such as evaluating the concept and application of the system of internal control. Also, personnel with a required skill or expertise should be available for reviews that require a skill not possessed by Internal Review.

e. The activities of Internal Review personnel should be concentrated on those relating directly to the established command Internal Review Program. Activities outside the Program, such as augmenting personnel in other Comptroller Department sections due to personnel requirements, should be done only on an emergency basis.

f. The annual program should be constructed to reflect the widened scope of internal review, including the elements required by MCO 7540.2A. Deviations from the approved plan should be approved by the Commanding Officer and progress against the plan should be monitored, updated on a quarterly basis, and reported.

g. Whenever possible and appropriate, reviews should be conducted to meet the GAO Standards. This will not only reduce the duplicative audits required but will produce the desired results of detecting problems, providing recommendations to prevent their recurrence, and followup to insure it.

h. Formal reporting and followup procedures should be instituted. SECNAVINST 7510.8, MCO 7540.2A, and the



Introduction to Navy Audit and Internal Review Text contain required and useful information for successful reporting and followup. Included are recommendations for correction of conditions that result in problems, such as the continuing problems of unfilled orders and personnel turnover. In addition, reports should attempt to establish a cost-benefit relationship of what the review cost and the quantitative and qualitative value of the findings. This will provide an indicator of value and performance, as well as establish a basis for staffing.

i. Institute training for personnel in other departments on key findings that are applicable so problem areas can be highlighted.

j. Training for Internal Review should include subjects related to reviews for effectiveness and efficiency in addition to the financial and fiduciary elements presently in the training plan. The Comptroller of the Navy offers an auditing short course that would be appropriate.

Regardless of the programs or procedures implemented, the success of any system depends on command support at all levels. If Internal Review is to be successful, such support must be available in a tangible form and on a continuing basis.





## APPENDIX A

### INTERNAL REVIEW - DEPARTMENT OF DEFENSE

SECNAVINST 7510.7A  
28 DEC 1978

- d. Internal Review at Lower Echelons. Management at lower echelons is not precluded from establishing groups which, while not performing independent or comprehensive audits, would serve as "trouble shooters" who may make special analyses in comptroller and other areas and assist in correcting deficiencies which are revealed by audits, reports, analyses, observations or other means. In authorizing such internal review activities at any echelon, care should be exercised to assure avoidance of duplication of internal audit functions as defined below which are assigned to the centralized audit organizations.

#### IV. INTERNAL AUDIT RESPONSIBILITIES, MISSION AND SCOPE

- A. The purpose of internal audit is to lead to action which will improve the operations of the Department of Defense. It is the independent review and evaluation of the effectiveness and efficiency with which managerial responsibilities are being carried out. It is an independent appraisal activity for the review of financial, operational, and support activities as a basis for protective and constructive service to management. Internal audit review and appraisal covers functions, organizations, systems, procedures, practices and transactions, records and documentation of all kinds. It is directed toward determining that management controls, practices and procedures at all levels are adequate in concept and effective in application and that they provide for adequate financial integrity and effective utilization of resources available. It is a managerial control which functions by measuring and evaluating effectiveness of other controls.
- B. Subject to the authority, direction, and control of their superiors, the heads of Defense internal audit organizations will develop and execute plans, policies, procedures, and programs necessary to discharge internal audit responsibilities.



7600.3  
Jan 4, 74

- C. To accomplish the overall objective of assisting management at all levels in achieving efficient and effective administration, audit activities of Defense audit organizations will include the following:
1. Reviewing and appraising the soundness, adequacy and application of accounting, financial and operating controls.
  2. Examining and appraising the adequacy and effectiveness of policies, systems, procedures, records, and reports relating to programming, budgeting, accounting, procurement, supply, financial or business transactions of all kinds, and other operations having an impact on the expenditure of funds, utilization of resources, or accomplishment of management objectives.
  3. Appraising performance under, and ascertaining the extent of compliance with, established policies, procedures, regulations, laws, etc.
  4. Ascertaining whether resources (funds, personnel, material and other property) are properly justified, utilized, accounted for, disposed of, and safeguarded from loss.
  5. Ascertaining the reliability of accounting and other data and reports developed within the DoD Components and the need for, timeliness, and usefulness thereof.
  6. Disclosing inefficiency, waste and other improper conditions and practices.
  7. Reporting the facts ascertained and making recommendations in connection therewith to appropriate levels of management.
- D. Internal audit is a staff function which, to operate effectively, must be completely independent of line operations. The internal auditor's responsibility is to examine, observe, review, and evaluate the policies, systems, and procedures, and the performance thereunder, respecting all aspects of management for the purpose of reporting findings and making recommendations for corrective action to management. The existence of an internal audit staff in



7600.3

Jan 4, 74

no way relieves other personnel of duties and responsibilities assigned to them. Full responsibility is vested in the DoD Components and the various commands therein for proper management; for protection and use of assets under their control; for compliance with directives from higher authority; and for the accuracy, propriety, legality, and reliability of their actions.

- E. While the scope of internal audit responsibility is broad, it does not include criticism of management decisions based upon after-the-fact substitution of the auditor's judgment for that of responsible management. Most management decisions involve risk and uncertainty. Thus, the fact that later events prove the decision to be wrong is not, taken by itself, a subject for audit reporting. It becomes a subject, however, when the decision indicates inefficient operations, inadequate procedures, or other deficiencies, the reporting of which would lead to future improvements in systems or procedures, or avoidance of errors. The following are illustrative:
1. Erroneous decisions made on the basis of incorrect or incomplete data because of deficiencies in the information system.
  2. Erroneous decisions arising from failure to consider data which were readily available at the time the decision was made.
  3. Decisions resulting in actions which were contrary to law, policy or regulations.
- F. The internal auditor does not have the authority to make changes, nor to order changes made, in the procedures or operations of the activities audited. The internal auditor is not responsible for developing systems, methods and procedures, nor for the performance of duties constituting a part of regular line operations. Such responsibilities would tend to give him a biased viewpoint when, in the course of his audits, he would be required to appraise his own work. However, the auditor may call attention to problem areas with respect to any of these matters and provide advisory assistance to system development personnel particularly with respect to such aspects of internal controls and audit trails.



SECNAVINST 7510.7A  
28 December 1978

7600.3  
Jan 4, 74

The auditor, based upon his independent examinations, reviews, and appraisals, provides an advisory service and makes recommendations to management for improvements and for the correction of deficiencies. It is the responsibility of management to determine what action will be taken and to give the required corrective orders. This, however, does not relieve the audit staff of the responsibility for following up on recommendations to determine whether they were given adequate consideration and that management's orders to accomplish changes and correct deficiencies were effectuated.





## APPENDIX B

### TRAINING PLAN

#### I. TITLE - Auditor, GS-09

Position - Head, Internal Review Division, Comptroller Department.

#### II. LENGTH OF TRAINING PERIOD

Auditor Trainee, GS-05 - From hire date for 1 calendar year depending on progress, qualifications and supervisor's recommendation.

Advanced Trainee, GS-07 - From promotion date to GS-07 for 1 calendar year.

III. OBJECTIVES. To train the incumbent from the grade of GS-05 to fulfill the Auditor position within the command. By college education, graduate education and on-the-job training the trainee will be able to apply standard audit procedures and install audit programs by obtaining a good working knowledge of accounting, budgeting, financial reports, data processing and systems theory and practice.

#### IV. TYPE TRAINING

##### A. On-the-job Training - GS-05

1. Accounting Division. Trainee will work in the Accounting Division for the first four months. Under supervision of the Accounting Officer, the trainee will progress through all phases of Funds Resource Branch, Stores Branch, Cost Accounting Branch, Civilian Payroll Branch, and Plant Property. While learning the basic systems the trainee will perform routine audit assignments; examine routine accounting documents to verify the accuracy of computations and ascertain that transactions tested are properly recorded and supported and are in accordance with pertinent laws and regulations. Trainee will perform studies and analyze existing data processing systems and directives for a three month period. Trainee will become familiar with data processing theory and systems theory. Liaison visits to Camp and/or COMCAB will be made to understand Data Processing organization.

2. Budgeting Division. Trainee will work in the Budgeting Division for a three month period, and will participate in the budgeting process from the Cost Center level to finalization at station level. Midyear review procedures will be understood and all budgetary reports will be reviewed for understanding of content.



3. On an as assigned basis, trainee will perform verification of inventories, tracing prices to invoices or price lists, counting cash, testing the aging of receivables and payables, listing balances of ledger accounts, preparing detailed statements and schedules for reports, and prepare simple reconciliations.

4. Comptroller Office. Work under the direction of the Deputy Comptroller to understand overall general financial budgetary and management policy.

B. On-the-job Training GS-7.

1. Work under the direction of the Deputy Comptroller to strengthen the understanding of the various divisions of the Comptroller Department. Serves as an Internal Review Auditor Trainee performing a wide range of audit assignments to prepare trainee to perform more difficult tasks. Trainee will be assigned audit duties to include cost centers, all branches of accounting, budget division, and other areas as directed. Analysis of data processing systems will be made with the intention of developing new or revised methods to change or supplement automated requirements. Spend at least two months working in areas of Supply to better understand the Financial/Supply interface. Spend at least one month in the Public Works Department financial section.

C. Special Projects or Assignments.

1. Cost Center Management. Perform an in-depth study of the Cost Centers to include:

- a. Financial Management.
- b. Budgetary Requirements.
- c. Cost Center-Supply System Interface.

2. Comptroller Department organization. Trainee will perform an in-depth study of how the Comptroller Department is organized, why, and how it compares to U. S. Marine Corps standards. All directives from higher authorities will be analyzed and an organizational manual, along with detailed instructions prepared to reorganize the department or substantiate current organization.

D. Rotational Assignments. Covered in on-the-job training. All areas in the Comptroller's Department, Cost Centers, Public Works, and Supply.

E. Self-Development. Participate in available professional societies and the below reading program:



NAVCOMPT Manual Vol. 7  
DOD 7045.1 Programming System  
DOD 7040.5 Definition of Expenses and Investment  
Costs  
DOD 7045.7 Review and Approval of Changes to FYDP  
DOD 7110-1-M-DOD Budget Guidance Manual  
Financial Management of Resources (Departmental and  
Field Activities) NAVSO P-3006

F. Persons responsible for implementing and coordinating training plan:

Deputy Comptroller

V. EVALUATION

A. Trainee Evaluation. A comprehensive written report of his total training experience will be required of the trainee at 6-month intervals while in training and upon completion of the total training period. Format similar to enclosure (1) will be used to make this evaluation.

B. Supervisory Evaluation. The trainee's progress will be continually evaluated throughout the program by the Program Coordinator. Quarterly reports will be submitted in format similar to enclosure (2), to the Comptroller, which evaluates the trainee's overall progress, demonstrated ability to apply the subject matter of the training to individual needs, and/or need to revise the program. If the Program Coordinator should determine at any time during the course of the training program that the trainee is not meeting the general standards as set forth in the training plan, an additional report shall be submitted to the Comptroller recommending appropriate action. When the Program Coordinator determines that the trainee has satisfactorily completed the objectives and requirements of the training program, she will certify that the requirements of the approved plan have been fulfilled and that the trainee is satisfactorily performing the duties at the respective level. This certification, along with the trainee's report and other supporting documents, will be submitted to the Comptroller.

VI. CERTIFICATION. The Comptroller will review the evaluation reports and forward these reports with appropriate recommendations to the Civilian Personnel Officer. At completion of the training program for each level, and when the incumbent is certified or qualified by the Civilian Personnel Officer, incumbent will be promoted accordingly.





## APPENDIX C

### FY1979 INTERNAL REVIEW PROGRAM

1. Monthly Requirements 28 Man Days
  - a. Audits: Funds issued to Imprest Fund cashiers, collection agents and custodians.
  - b. Reports: Verify the accuracy of the monthly Commissary Store Report and the Flying Hour Cost Report.
2. Quarterly Requirements 13 Man Days
  - a. Audits: Audit cash/vouchers held as cash and other assets as recorded in the Disbursing Officer's official cash book.
  - b. Reports: Verify the accuracy of the Banking Facility Report.
3. Annual Requirements 45 Man Days
  - a. Audits: Civilian Payroll and Timekeeping procedures.
  - b. Reports: Preparation of the Internal Review Program Report.  
Prepare/Review Commercial/Industrial Activities Inventory Report.
4. Bi-Annual Requirements 45 Man Days
  - a. Audits: Special Deposit Accounts established with the Disbursing Officer by private parties. Verify accuracy and ensure proper procedures are being used by Fund Administrators in maintenance of Memorandum Accounting Records for fund control. Also, ensure proper utilization of funds.
5. As Assigned/Required 60 Man Days
  - a. Follow-up on own previous audits to ensure corrective action(s) are being taken and approved recommendations have been implemented.
  - b. Coordinate, assemble, forward to CMC, and follow-up on audits by outside agencies.
  - c. Review and submit recommendations concerning local directives.
  - d. Conduct audits of unforeseen problems on an "as required" basis.
6. Training 49 Man Days
  - a. Annual training of an Accountant-Auditor GS-510 - 5/7/9 in all areas of financial management in the Department of the Navy and Marine Corps so that Journeyman level can be reached in two years.



FY1979 INTERNAL REVIEW PROGRAM (Continued)

- |    |                                 |              |
|----|---------------------------------|--------------|
| 7. | <u>Leave</u>                    | 20 Man Days  |
|    | a. Earned Annual Leave.         |              |
| 8. | <u>Total Man Days Scheduled</u> | 260 Man Days |



# APPENDIX D

## REPORT OF OPERATIONS OF INTERNAL REVIEW

ACTIVITY: MCAS, PERIOD: 1 Oct 78 to 31 Mar 79

1. Personnel Authorized as of End of Reporting Period NUMBER

Professional	
Civilian	1 (Trainee)
Military	-0-
Sub-total	<u>1</u>
Administrative	
Civilian	-0-
Military	-0-
Sub-total	<u>-0-</u>
TOTAL	<u><u>1</u></u>
  
2. Operating Costs Incurred During Reporting Period AMOUNT

Civilian Personnel	\$7,204
Military Personnel	-0-
Travel	850
Other	50
TOTAL	<u><u>\$8,104</u></u>
  
3. Workload Data Applicable to Reporting Period NUMBER OF PERSONNEL

a. Recognized Requirement as of end of period	2
b. Assigned as of end of period	1
c. Shortfall	<u><u>1</u></u>
  
4. Operational Highlights  
Operations during this reporting period included:
  - a. Study of procedures utilized in collecting and controlling cash funds.
  - b. Study of the interface between Supply/Accounting Fund Administrators.
  - c. Two off-station training courses.
  
5. Reports Issued and Resources Applied During Reporting Period  
No formal reports issued during reporting period.
  
6. Significant Findings of Waste  
None.
  
7. Potential Fraud Cases Referred to Investigative Organizations during Reporting Period  
None.



APPENDIX E  
INTERNAL REVIEW REPORT

From: Internal Review

To: Commanding Officer

Via: Comptroller

Subj: Review of Funds Status as of 23 August 1979 - S-3 Fund  
Administrator Codes D2, E1 and E3

Obj: To ascertain Memo Record balances in an attempt to present  
overexpenditure of FY79 funds allocated to the S-3 activity.

1. Balances at the end of the first quarter were not carried forward to the second quarter. Correction was made at the time of the review by the Fund Administrator.

2. A verbal decrease of authorization was shown in the second quarter. However, the third quarter authorization reflected the decrease. The record was adjusted in the course of the review by the Fund Administrator.

3. After the above adjustments were recorded, the following balances as of 23 August appear in the Memo Record:

Structural Fire Department (D2)	\$ 231.13
Air Field Operations (E1)	3,947.31
Crash and Rescue (E3)	1,711.13

4. It was determined that the Unfilled Requisition Report of 31 July 1979 lists a total of 47 documents which have either been cancelled or completed per S-3 records. Following is a breakdown by fund code:

	<u>No. of Documents</u>	<u>Amount</u>
Structural Fire Department (D2)	6	\$ 1,257.11
Air Field Operations (E1)	15	1,203.48
Crash and Rescue (E3)	<u>26</u>	<u>11,787.55</u>
Total	47	<u>\$14,248.14</u>

These documents have been called to the attention of the accounting activity.

5. Following is an aging of the above mentioned documents from date of initiation to cancellation or completion and from julian date of document to julian date of the UR Report.





	<u>1 to 10 Days</u>	<u>11 to 30 Days</u>	<u>31 to 60 Days</u>	<u>61 to 90 Days</u>	<u>91 to 180 Days</u>	<u>Over 180 Days</u>
Completed/Cancelled	21	17	7	0	2	0
Age per UR Report	1	13	6	6	12	9

6. The timeliness of paper flow between the initiating activity, Supply, Data Processing and Accounting activities is less than desirable. However, the type of material ordered, priority, whether it is a direct turnover item, a supply system item, a procurement or a contract item makes a vast difference in the timeliness of the paper flow. Procurement items requiring a competitive bid, or a cost estimate may take several months between the initiation of the document and the completion of the document. Therefore, it is nearly impossible to determine the time lag in processing a requisition/document from start to finish.

7. It appears that the present fund balance on hand 23 August 1979 is insufficient to cover normal operations in the D2 activity.

8. Following is a reconciliation of Memo Record balances to the mechanized report balances:

	<u>D2</u>	<u>E1</u>	<u>E3</u>
Mechanized balances	<u>\$ (424.00)</u>	<u>\$7,720.00</u>	<u>\$44,702.00</u>
Memo Record balance	\$ 231.13	\$3,947.31	\$ 1,711.13
FY Documents in FY79 mech. reports	(802.98)	-0-	-0-
UR's	-0-	500.36	27,951.72
Documents not on mechanized report	-0-	3,344.71	11,817.87
Price Variances	<u>147.85</u>	<u>(72.38)</u>	<u>3,221.28</u>
	<u>\$ (424.00)</u>	<u>\$7,720.00</u>	<u>\$44,702.00</u>

The FY78 documents above have been reported to the accounting activity for correction of entry. Each transaction was completed prior to 16 August 1978 and therefore belong in FY78 business.



## APPENDIX F

### GLOSSARY OF TERMS

AUDIT TRAIL -- Accumulation of source documents and records which are the support of transactions that occurred during the period under audit.

BAYESIAN STATISTICS -- A method of computing the probability of a state of nature and modification of the probability by using information gathered from an experiment.

CONFIDENCE LEVEL -- Refers to the extent the auditor connects the statistical term with the auditor's subjective confidence in support of a proposition.

GENERALLY ACCEPTED ACCOUNTING PRINCIPLES -- Principles used to evaluate financial accounting information -- they are established by authoritative bodies, such as the Financial Accounting Standards Board and the Securities and Exchange Commission, or by long usage in practice.

JUDGEMENT SAMPLE -- A sample where the size of the sample and individual items in the sample are chosen on the basis of sound reasoning by the auditor.

REPRESENTATIVE SAMPLE -- A sample that possesses the same characteristics and in the same proportion as the population.

TELAUTOWRITER EQUIPMENT -- Equipment used by operating organizations to order parts from supply by directly transmitting handwritten information to supply at the time it is written.



## FOOTNOTES

<sup>1</sup>President Jimmy Carter, The Joint Financial Management Improvement Program Audit Management Project, Report on Audit of Federally Assisted Programs; A New Emphasis, February 1979, p. i.

<sup>2</sup>Joint Financial Management Improvement Program, A Checklist for New Agencies Designing and Implementing Financial Management Systems, February 1979, first page.

<sup>3</sup>Office of Management and Budget Memorandum for Heads of Executive Departments and Agencies of May 7, 1979.

<sup>4</sup>Naval Audit Service Headquarters Point Paper NAVAUDSVC HQ (0-22) of 3 November 1978.

<sup>5</sup>Ibid.

<sup>6</sup>RADM James B. Busey, Auditor General of the Navy, lecture at the Naval Postgraduate School on 28 August 1979.

<sup>7</sup>Ibid.

<sup>8</sup>Ibid.

<sup>9</sup>United States General Accounting Office, Standards for Audit of Governmental Organizations, Programs, Activities and Functions, 1972, pp. 1 to 2.

<sup>10</sup>Robert N. Anthony and Regina E. Herzlinger, Management Control in Nonprofit Organizations, (Irwin, 1975), p. 16.

<sup>11</sup>United States General Accounting Office, Internal Auditing in Federal Agencies, 1974, p. 1.

<sup>12</sup>Alvin A. Arens and James K. Loebbecke, Auditing: An Integrated Approach, (Prentice-Hall, 1976), p. 3.

<sup>13</sup>Ibid.

<sup>14</sup>Ibid., p. 6.

<sup>15</sup>Committee on Basic Auditing Concepts, 1969-71, "Report on Basic Auditing Concepts," The Accounting Review, Supplement to Volume XLVII, 1972, p. 21.

<sup>16</sup>Arens and Loebbecke, pp. 38 to 40.

<sup>17</sup>Ibid., p. 40.





- <sup>18</sup>Ibid., p. 12.
- <sup>19</sup>Ibid., pp. 105 to 108.
- <sup>20</sup>Donald M. Roberts, Statistical Auditing, American Institute of Certified Public Accountants, 1978, p. 2.
- <sup>21</sup>Arens and Loebbecke, pp. 88 to 110.
- <sup>22</sup>Ibid., pp. 14 to 18.
- <sup>23</sup>Ibid., pp. 18 to 23.
- <sup>24</sup>Ibid., pp. 157 to 179.
- <sup>25</sup>Internal control (Committee on Auditing Procedure), AICPA (New York, 1949), p. 6.
- <sup>26</sup>Arens and Loebbecke, pp. 161 to 168.
- <sup>27</sup>Ibid., pp. 376 to 398.
- <sup>28</sup>Arens and Loebbecke, p. 12.
- <sup>29</sup>The Institute of Internal Auditors, Inc., "Standards for the Professional Practice of Internal Auditing," The Internal Auditor, October 1978, pp. 9 to 30.
- <sup>30</sup>Lawrence B. Sawyer, The Practice of Modern Internal Auditing, (The Institute of Internal Auditors, Inc., 1973), p. 2.
- <sup>31</sup>United States General Accounting Office, Comprehensive Audit Manual, July 1978, Introduction.
- <sup>32</sup>United States General Accounting Office, GAO Manual for Guidance of Federal Agencies, Latest Edition, Introduction.
- <sup>33</sup>GAO Manual for Guidance, pp. 3-16 to 3-21.
- <sup>34</sup>Ibid., pp. 3-21 to 3-24.
- <sup>35</sup>GAO Standards for Government Organizations, Programs, Activities and Functions, pp. 6 to 54.
- <sup>36</sup>United States General Accounting Office, Comprehensive Audit Manual, July 1978, pp. 9-14 to 9-17.
- <sup>37</sup>GAO Internal Auditing in Federal Agencies, pp. 27 to 31.
- <sup>38</sup>GAO Manual for Guidance, pp. 3-41 to 3-64.



<sup>39</sup>GAO Comprehensive Audit Manual, pp. 11-1 to 11-8.

<sup>40</sup>GAO Manual for Guidance of Federal Agencies, p. 3-43.

<sup>41</sup>Department of the Navy, Office of the Comptroller, Introduction to Navy Audit and Internal Review Text, February 1979, pp. 18 and 19.

<sup>42</sup>Department of Defense Directive 7600.2, "Audit Policies," August 7, 1978, pp. 1 to 7.

<sup>43</sup>Department of Defense Instruction 7600.3, "Internal Auditing in the Department of Defense," January 4, 1974, pp. 1 to 22.

<sup>44</sup>Ibid., p. 6.

<sup>45</sup>Phone call from author to Mr. Brown in the office of the Director For Internal Audit Policy, Department of Defense, on 2 November 1979.

<sup>46</sup>Department of Defense, Joint Study Group on Audits, Inspections and Reviews, Draft of Study and Relationships of Audit, Inspection and Review Groups in the Department of Defense, November 3, 1978, pp. 11 to 43.

<sup>47</sup>Secretary of the Navy Instruction 7510.8, "Internal Review in the Department of the Navy," 15 October 1976, p. 1.

<sup>48</sup>Secretary of the Navy Instruction 7510.7A, Department of the Navy Audit Manual for Management, 28 December 1978.

<sup>49</sup>Introduction to Navy Audit, p. 66.

<sup>50</sup>SECNAVINST 7510.8, p. 1.

<sup>51</sup>Secretary of the Navy Instruction 7510.8, "Internal Review in the Department of the Navy," 15 October 1976, p. 2.

<sup>52</sup>DODINST 7600.3, p. 6.

<sup>53</sup>SECNAVINST 7510.8, p. 2.

<sup>54</sup>Ibid., Encl (1), p. 1.

<sup>55</sup>DODINST 7600.3, p. 6.

<sup>56</sup>Phone call from author to Mr. G. White, Management Consulting Division, Headquarters, Naval Audit Service, 13 September 1979.

<sup>57</sup>Introduction to Navy Audit, pp. 65 to 84.



<sup>58</sup>Phone call from author to Mr. M. Ragusa, Internal Review, Headquarters, United States Marine Corps, of 16 October 1979.

<sup>59</sup>Phone call from author to Ms. Stevens, Management Analyst, Manpower Survey Team, Headquarters, United States Marine Corps, of 1 November 1979.

<sup>60</sup>RADM James B. Busey, Auditor General of the Navy, lecture at the Naval Postgraduate School on 28 August 1979.

<sup>61</sup>DOD Joint Study Group Report, pp. 11 to 43.



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